Office of Utility Regulation

Guernsey Post's Proposed Tariff Changes

Final Decision

Document No: OUR 09/21 **December 2009**

Office of Utility Regulation
Suites B1 & B2, Hirzel Court, St Peter Port, Guernsey, GY1 2NH
Tel: (0)1481 711120, Fax: (0)1481 711140, Web: www.regutil.gg

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1. Introduction

In January 2009 Guernsey Post Limited ("GPL") applied to the Director General ("DG") for a one year price control to be determined, rather than the normal three year price control. This request was granted by the DG at the start of February 2009. Subsequently, in May 2009 GPL applied to the DG to change both the level and structure of its tariffs for the period April 2010 to April 2011.

In particular, GPL applied to the OUR to:

- revise its postal tariffs with effect from 1st April 2010;
- implement Pricing in Proportion ("PiP") from April 2010 onwards for all postal customers; and
- have an increase in the Reserved Area from the current £1.35 to £2.15 (within the reserved area GPL has an exclusive right to provide postal services).

In August 2009 the DG issued a public consultation document which focused on the principles behind PiP and the Reserved Area. The consultation also considered the nature and effect of the changes GPL was proposing to the level of tariffs. Following consideration of the responses to the consultation, the DG published his Draft Decision in October 2009. The Draft Decision focused on:

- the responses to the August 2009 consultation;
- the efficiency review of GPL;
- the scope for Down Stream Access ("DSA");
- the DG's views on PiP;
- the DG's views on the appropriate level of the Reserved Area; and
- the DG's proposed postal tariffs with effect from 1st April 2010.

The DG received 24 written responses to the Draft Decision of which 7 were confidential. In addition to the more detailed comments received, the DG also acknowledges the receipt of in excess of 1700 business reply cards and emails received as a result of a public campaign by Guernsey Post and acknowledges the comments made on a Facebook social networking site.

Having considered the responses received and such additional information as is available to him, the DG is setting out his Final Decision on these matters in this document.

This Final Decision document forms the end of the consultation process on determining GPL's tariffs for the period from April 2010 to April 2011. The Final Decision focuses on the following areas:

- the responses to the October 2009 Draft Decision;
- the efficiency savings taken into account in determining allowed revenue for April 2010 – April 2011;
- the DG's decision on PiP, including weight steps and international mail dimensions;
- the DG's decision on the Reserved Area;

- the DG's decision on the postal tariffs with effect from 1st April 2010.

The tariffs set out in this Final Decision and the other issues, including the Reserved Area, which the DG has now determined will take effect from 1st April 2010.

Among the key decisions are:

- The Reserved Area will now be reduced to include all items below £1.00 except for packets – for packets, the market will now be fully open to competition;
- The DG expects GPL to make approximately £800,000 efficiency savings during the price control period;
- The DG is allowing some additional weight steps for large letters and packets and hence tariffs for these products are changed from those proposed in the Draft Decision; and
- The UK stamp will increase to 45p from 1st April 2010; the local stamp price will remain unchanged at 36p.

The DG believes this package of measures best allows him to meet his statutory duties in the Regulation of Utilities (Bailiwick of Guernsey) Law 2001 and the various directions given to him by the States insofar as they relate to the postal market.

The DG would like to thank all parties for their contributions to this review in helping finalise this decision and in particular Guernsey Post and the bulk mail sector for their assistance.

2. Structure and Comments

2.1. Structure of the Consultation Paper

The rest of this document is structured as follows:

Section 3:	describes the legislative framework and licensing arrangements which give the DG power to price control certain areas of GPL's postal activities and determine the level of the Reserved Area and sets out the process followed as part of this price control review;
Section 4:	summarises the main findings of the 2009 Efficiency Review of GPL and sets out respondents' views in relation to this issue and the DG's final view;
Section 5:	summarises the issues in relation to DSA and the responses on this issue and sets out the DG's final view on this issue;
Section 6:	sets out the main issues in relation to the introduction of PiP, including respondents' views and it sets out the DG's final decision on PiP;
Section 7:	summarises the DG's draft proposals on the Reserved Area and sets out respondents' views on this issue and the DG's final decision on the Reserved Area;
Section 8:	contains the DG's decision on postal tariffs from 1st April 2010;
Section 9:	sets out the DG's intentions with regard to licensing new postal providers in the postal market; and
Section 10:	sets out next steps.
Annex A	Postal tariffs which come into effect from 1st April 2010
Annex B	Approach to the Reserved Area in other Jurisdictions
Annex C	Lists the respondents to the Draft Decision consultation

In accordance with the OUR's policy on consultation set out in Document OUR 05/28 – "Regulation in Guernsey; Revised Consultation Procedures Information Paper" – all non-confidential responses to the Draft Decision have been published on the OUR's website (www.regutil.gg) and are available for inspection at the OUR's office during normal working hours.

3. Legislative and Licensing Background

3.1. Legislation and States Directions

The main legislative provisions of relevance to this Decision are contained in two Laws, The Regulation of Utilities (Bailiwick of Guernsey) Law, 2001 (the "Regulation Law") and The Post Office (Bailiwick of Guernsey) Law, 2001 (the "Postal Law").

The Regulation Law created the office of the DG and set out the DG's duties in section 2 of the Regulation Law. These include:

- the protection of the interests of consumers and other users in the Bailiwick in relation to the prices charged for utility services generally;
- securing the provision of utility services which satisfy all reasonable demands for such services within the Bailiwick;
- ensuring that services are carried out in such a way as to best serve and contribute to the economic well being of the Bailiwick;
- the introduction, maintenance and promotion of effective and sustainable competition in utility services; and,
- the improvement of quality and coverage of utility services.

The Regulation Law provides that the States of Guernsey may issue States' Directions to the DG[1] in relation to:

- the identity of the first licensee in a utility sector;
- the extent of any special or exclusive rights to be awarded to a licensee;
- the scope of the universal service that should be provided; and
- any obligations arising from international agreements.

The Regulation Law further requires that the DG "*shall comply*" with States' Directions, except where to do so would be in contravention of the duty imposed on him under section 2 of the Law or any of his functions or powers. Accordingly, it is mandatory that the DG comply with States Directions, save where these conflict with his duties under section 2 or any of his functions or powers.

Pursuant to section 2(1A) of the Regulation Law, the States may give the DG directions of a strategic or general nature by Ordinance.

In relation to the postal utility generally, the Postal Law prohibits the provision of postal services without a licence. However, section 1(2) contains a number of important exceptions to this provision, with the effect that a range of postal activities do not require licensing, such as personal delivery by a sender, to the delivery of court documents and banking instruments[2].

In addition, any postal services which are provided outside the 'reserved area' can be provided without the need for a licence. Thus, postal services which currently are provided for a price of more than £1.35 (the "non-reserved services") can be provided

[1] Section 3 of the Regulation Law
[2] Section 1(2) of the Post Office (Bailiwick of Guernsey) Law, 2001

without a licence. The reserved area was fixed at £1.35 pursuant to an Order given by the DG in 2001, in accordance with section 9 of the Postal Law[3]. As a result, all services which are provided for a price of less than £1.35 are deemed to be reserved services.

3.1.1. States' Direction: The Universal Service Obligation

In September 2001[4], the States issued a Direction to the DG requiring the DG to issue the first licence to provide universal services to GPL. At the same time, the States set out the universal service obligation ("USO") which should be imposed on GPL, namely:

> *"… throughout the Bailiwick of Guernsey at uniform and affordable prices, except in circumstances or geographical conditions that the Director General of Utility Regulation agrees are exceptional:*
> - *One collection from access points on six days each week;*
> - *One delivery of letter mail to the home or premises of every natural or legal person in the Bailiwick (or other appropriate installations if agreed by the Director General of Utility Regulation) on six days each week including all working days;…*
> - *Collections shall be for all postal items up to a weight of 20Kg;*
> - *Deliveries on a minimum of five working days shall be for all postal items up to a weight of 20Kg;*
> - *Services for registered and insured mail."*

Having defined the USO, the States directed that GPL should be awarded the exclusive right to provide postal services *in the Bailiwick, to the extent that such exclusive right is necessary to ensure maintenance of the USO.* The relevant States' Direction also requests the DG to[5]:*"review and revise the award of exclusive services…with a view to opening up the Bailiwick postal service market to competition, provided that any such opening up does not prejudice the continued provision of the USO".* These exclusive services are termed the "Reserved Area" or "RA" in this Decision.

The Regulation Law and the States' Directions were preceded and informed by the States Advisory and Finance Committee's Policy letter of 24 August 2001. The Policy letter usefully explains the rationale behind the introduction of the Regulation Law and the intention as regards regulation of particular sectors. The Policy letter explains that the intention behind the creation of a Reserved Area was to enable revenues from that monopoly granted over the provision of the reserved services to be used to fund the USO.

[3] The Post Office (Reserved Postal Services) Order, 2001
[4] Billet D'Etat XXVIII of 2001, 26 September 2001, p.1259 onwards
[5] Billet D'Etat, 26 september 2001, p.12560 [check]

3.1.2. The determination of the size of the RA

The Policy letter[6] outlined a number of matters that might be considered in order to decide on the size of the RA, namely:

- Information on volumes of postal traffic, prices, revenues and costs;
- Guernsey Post's relationship with the UK postal services and any changes to that relationship that might take place given the recent changes in the UK postal sector; and
- Developments in Jersey as to postal services and regulation.

It was also noted that[7]:

> *"It is important that Guernsey keeps abreast of the developments elsewhere and is not seen to be restrictive or unnecessarily slow in developing the postal sector, as this would not enhance the image of Guernsey as a vibrant place to do business".*

3.1.3. The DG's remit to change the RA

States' Direction

In line with the above, it was recommended:

> *(...) that the States issue a Direction to the Regulator at this time to set the reserve sector at a level sufficient to ensure that the universal postal service is met and to review the reserve area from time to time and make amendments to bring about the gradual opening of the postal market consistent with that aim."*[8]

In line with this, the States issued the following Direction[9]:

"(...) request the Director General to review and revise the award of exclusive rights from time to time with a view to opening up the Bailiwick postal services market to competition, provided that any such opening up does not prejudice the continued provision of the universal postal service."

The Regulation Law

As set out above, under the Regulation Law one of the objectives which both the States and the DG have a duty to promote is the introduction, maintenance and promotion of effective and sustainable competition in the provision of utility services, subject to any special or exclusive rights awarded to a licensee by the DG pursuant to States' Directions (section 2(d)).

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[6] *Ibid, paragraph 7.12*
[7] *Ibid, paragraph 7.13*
[8] *Ibid, paragraph 7.13*
[9] *Ibid, p.1264 and resolution at page 80.*

Also as noted above, section 3 of the Regulation Law gives the States the discretion to give directions to the DG, including in respect of special or exclusive rights to be awarded to any licensee (section 3(1)(b)). The DG is required to comply with States' Directions when exercising his functions and powers, unless to do so would contravene a duty imposed by section 2 or any of his functions and powers.

Under section 5 of the Regulation Law, the DG has the power, having regard to his duties and functions and subject to the provisions of States' Directions, to determine which USOs may be imposed on a licensee, on what conditions, how and by whom such obligations should be funded (section 5(1)(d)).

The Postal Law

Section 9(1) of the Postal Law provides that the DG may, by Order, designate certain postal services to be reserved services, provided the DG believes that (i) this is necessary to enable the provision of a universal postal service or (ii) to comply with States' Directions (section 9(2)). Section 9(3) of the Postal Law provides that such an Order may be amended or revoked by a subsequent Order.

The DG made an Order under section 9 of the Postal Law on 1 October 2001, designating all postal services which are provided for a price of £1.35 or less as the RA. Accordingly, GPL has a monopoly on all postal services below this area but faces competition for postal services which are not covered by the RA, i.e. those priced above £1.35. Despite increases in postal tariffs the level of the RA has not been revised and there has, therefore, in effect been a gradual reduction in the size of the RA.

3.1.4. Statutory Functions and Powers

In exercising his functions and powers, the DG has a duty to promote (and, where they conflict, to balance) the objectives[10] set out above at paragraph 3.1 and which are based on section 2 of the Regulation Law.

States' Directions[11] to the DG also require him:

- to ensure that the licensee (i.e. GPL) who is charged with providing the USO in the postal sector, does so throughout the Bailiwick of Guernsey at uniform and affordable prices; and
- to award the exclusive right to provide postal services in the Bailiwick to the extent that such exclusive right is necessary to ensure the maintenance of the universal postal service.

[10] The Regulation of Utilities (Bailiwick of Guernsey) Law, 2001
[11] States Resolutions 2001, pages 78-80 (item no 14)

3.1.5. Licence Conditions

Non-reserved services

Any postal services which are provided for a price *greater than £1.35* (the "non-reserved services") can be provided by *any person or business without a licence*.

In addition, and as set out above, The Postal Law provides that a range of postal activities do not require licensing, ranging from personal private delivery to the delivery of court documents and banking instruments[12].

USO services outside the reserved area

Condition 18 of GPL's licence was amended in 2005 to allow the DG to price control GPL's USO services (outside the reserved area) where it has been found by the DG to be dominant. In accordance with Condition 18.3 of GPL's licence, the DG may regulate the prices of GPL where GPL is dominant. The relevant licence condition states:

> *"The Director General may determine the maximum level of charges the Licensee may apply for Licensed Services and/or Universal Services within a Relevant Market in which the Licensee has been found to be dominant. A determination may:*
>
> > *(a) provide for the overall limit to apply to such Licensed Services and/or Universal Services or categories of Licensed Services and/or Universal Services or any combination of Licensed Services and/or Universal Services;*
> > *(b) restrict increases in any such charges or to require reductions in them whether by reference to any formula or otherwise; or*
> > *(c) provide for different limits to apply in relation to different periods of time falling within the periods to which any determination applies.*

In conclusion the DG has the power to directly regulate the prices that GPL charges for services provided within its USO.

In November 2005 the DG designated GPL as being dominant[13] in the following markets:

- the market for regular letter and parcel services;
- the market for priority (SD) letter and parcel services; and
- the market for outbound bulk mail services

For the purpose of the current price control the DG has determined the prices for all the above services as GPL has been found dominant in providing these services.

[12] Section 1(2) of the Post Office (Bailiwick of Guernsey) Law, 2001
[13] Document OUR 05/26 Review of Market Domin ance in the Guernsey Postal Market – Report on the consultation and Decision Notice, November 2005

3.2. Responses to the Draft Decision

This section only deals with responses in relation to legal issues, e.g. the DG's remit.

In its response to the Draft Decision, GPL states that the DG's remit to amend the RA, is constrained by the relevant laws and States' Directions (as discussed in the previous section of this chapter), including that the making of an order:

> *"(…) would not prejudice the provision of the USO"*

In GPL's view, the DG cannot ensure that revising the RA as proposed in the Draft Decision, would not prejudice the provision of the USO by GPL. Furthermore, GPL is of the view that the DG cannot take into account what it calls 'speculative' efficiency savings when determining the level of the RA. According to GPL[14]:

> *"The Director General has the burden of being satisfied that there is no prejudice to the universal service; there is no burden upon any person objecting to the opening up to competition to show that there is prejudice to the universal service."*

In its response, the Policy Council[15] did not dispute "the right of the DG to set the extent of the RA or that the current States Direction implies that the ultimate aim is to remove the RA completely".

The C&E Department notes that the Direction given to the DG to review and revise the award of exclusive rights, as set out in paragraph 3.1.3, is in line with the developments occurring or which have occurred in postal service markets elsewhere. It stresses in its response that it is essential that the DG, in coming to a final decision takes the interests of the bulk mailing ("BM") industry fully into account given the significant benefits it brings for the Island. It also considers that "it would be advisable for any proposal to remove the RA completely to be referred to the States for consideration, and any such proposal should also give consideration as to whether it would be advisable to introduce a licensing regime for potential competitors as already exists in the Jersey legislation".[16]

3.3. DG's views

The DG notes the unambiguous terms of the Regulation and Postal Laws as outlined above. In keeping with the clear statutory duties imposed upon him, the DG remains of the view that it is within his remit to determine the size of the RA if he considers that GPL will be able to provide the Universal Service. However, in his Final Decision for this one year price control the DG has determine to retain a RA at a level that retains GPL's monopoly on postal services for a large part of the postal market. He believes such an approach, at this time, best enables him to meet his statutory duties.

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[14] GPL response to the Draft Decision, p.5
[15] Policy Council response to the Draft Decision, p.1
[16] C&E response to the Draft Decision, p.6

The DG accepts that he has to ensure that his decision to revise the RA does not prejudice the Universal Service, as GPL contends. However, in his assessment whether GPL is able to provide the Universal Service, the DG is of the view that it would be entirely appropriate to take projected efficiency savings into account. In the DG's view, it cannot be the case that a monopoly is rewarded for perpetuating or aggravating inefficiencies to avoid the threat of competition. If identified efficiency savings are not to be taken into account, the licensee is effectively rewarded for being inefficient. Given the DG's statutory duties (i) to protect the interests of postal users; (ii) to serve and contribute to the economic and social development and well-being of the Bailiwick; and (iii) to introduce, maintain and promote effective and sustainable competition, amongst his other duties, the DG regards it as inarguable that he should not only take projected efficiency savings into account, but also that he should have due regard for the interests of BMs, as indeed the C&E Department identified in its response.

3.4. The Price Control Process

The DG has various statutory obligations to consult in respect of certain of his decisions. The DG's approach to consultation procedures has been set out in Document No. OUR 05/28[17].

This one year price control review has strictly adhered to the process set out in Document No. OUR 05/28, thereby ensuring full compliance with the DG's statutory obligations. The DG has published two consultation documents, namely the August Consultation and the October Draft Decision, on both of which he has invited respondents' views. Both publications were accompanied with significant media coverage to ensure that interested stakeholders were aware of the process and to enable them to engage in the proposals, if they so desired. The DG, in making this Final Decision, has had regard to the submissions made by all stakeholders.

In addition, there has been an on-going dialogue between the OUR and GPL during this review. The DG has had regard to information which has been provided to him as part of this on-going dialogue. Specifically, there has been extensive engagement between the OUR and GPL and other interested parties. For example, against this background and ethos, the OUR has had in excess of 20 meetings with various representatives of GPL since the outset of this decision-making process. Moreover, since the second half of February, there has been a high level of contact between the OUR and GPL staff on a variety of issues relevant to this decision. The DG considers that his approach has been a collaborative approach and that he has given due consideration to all relevant information which has been submitted to him, including consulting further (where necessary) with his expert advisers.

The DG has also made it clear that the rationale of a Draft Decision is to enable stakeholders to give respondents the opportunity to provide any further information and to submit relevant evidence supporting their views that they believe the DG

[17]OUR 05/28, Regulation in Guernsey, Revised Consultation Procedures Information Paper, November 2005, available at http://www.regutil.gg/docs/OUR0528.pdf

should have regard to when making his final decision. However the DG is fully aware of his duties to ensure that this is an inclusive process as opposed to, for example, a bilateral negotiation with GPL, even allowing for its particular interest in this issue. The DG is mindful of his obligations to be open and transparent in how he makes regulatory decisions which impact on consumer and postal providers.

Apart from the publication of the public consultation documents, the DG had a large number of meetings with stakeholders. The DG considers that he has used all reasonable endeavours to ensure that stakeholders have a good understanding of the basis on which he has reached his decision through extensive involvement of the stakeholders, including GPL, in his decision making process.

The DG has also taken the step of issuing two formal requests for information, which have produced further information that has been of assistance in reaching a conclusion.

The DG has also had the benefit of expert analysis and advice from Brockley Consulting, whose report is discussed later in this report. The DG has considered and evaluated the Brockley Consulting report carefully and with regard to the responses received.

Following the process of engagement with interested parties and reviewing the documents submitted to him, as well as evaluating the independent evidence available to him, the Director General has finalised his decision on the matters under review as part of this price control and these are set out later in this paper.

4. The Efficiency Review of GPL

In the Draft Decision, the DG set out his views and findings arising out of efficiency review of GPL conducted on his behalf by Brockley Consulting (the "**2009 Efficiency Review**").

4.1. 2009 Efficiency Review

The main findings arising out of the 2009 Efficiency Review were set out in the Draft Decision and are summarised in this section 4.1. The outcome of the 2009 Efficiency Review was discussed extensively with GPL before the publication of the Draft Decision and also in the run up to this Final Decision. The 2009 Efficiency Review identified approximately £2.0m in savings that the DG believes could be made in the postal business during 2010/11, of which £1.6m related to the price controlled business. It is not intended to repeat the detail of the findings here and interested parties should refer to the Draft Decision should they require further background on this issue.

4.1.1. Postal Operations

The review found there is a continued positive attitude among staff and improvements in the manner in which staff are managed and there have been some substantial improvements in operations since an earlier efficiency review in 2006, including:

- a reduction in headcount and total hours;
- the absorption of increased volumes from a major mailing customer; and
- the maintenance of quality of service.

However, significant opportunities continue to exist to reduce GPL's cost base. In particular, in the short term:

- levels of overtime are considered to be too high in both processing and delivery and should be reduced from the levels forecast; and
- the increase in processing hours forecast by GPL as necessary to meet increased volumes from a major mailing customer is unnecessary, given opportunities currently available to make more efficient use of existing hours.

The 2009 Efficiency Review identified further longer-term opportunities to reduce hours in both processing and delivery, several of which opportunities were also highlighted in the 2006 Efficiency Review, but have yet to be addressed by GPL.

4.1.2. Royal Mail charges

Despite the latest increases in rates, the Royal Mail contract remains competitive against all available Royal Mail benchmarks, with the exception of its DSA tariffs, which appear to offer significant savings for BMs sending items by sea.

It is recognised that a DSA based service would differ in some respects from GPL's existing products, and the DG has therefore not assumed any savings in respect of Royal Mail charges when considering the tariffs for these products. The opportunities afforded by DSA are however considered further in the following section.

4.1.3. Air Conveyance costs

A forecast doubling in air conveyance costs in 2010/11 was noted, primarily as a result of an expected need for a second aircraft at the start of 2010/11.

The 2009 Efficiency Review conclusion was that a second aircraft appeared to be warranted by the forecast increase in mail volumes.

4.1.4. Retail Network costs

The proportion of the costs of the Smith Street office which are allocated to postal services remains too high, despite reductions put forward by GPL, because the current level of specification for that office appears to be driven largely by non-postal activities. Accordingly, the allocation should be reduced further to a level which brings the cost of Smith Street to postal users more into line with the costs of the other offices in GPL's network.

4.1.5. Overheads

It was noted that over the course of the last four years, GPL's overhead costs have more than doubled, from £2.9m in 2005/06 to £5.9m in 2009/10, and that current overhead costs are £2.2m higher than that forecast at the time of the 2006 Price Control Review by GPL management for the current year.

Consideration was given to the detailed bottom up explanations provided by GPL to explain the increases in costs. However the conclusion was that bottom up explanations of the apparent reasonableness of individual items of expenditure cannot by themselves constitute a valid justification for such a significant increase in total overheads, since this ignores the requirement for an efficient operation to control the total level of its overheads in relation to the cost of its front line activities, and prioritise support expenditure within the envelope created by that top down control.

Concern was also expressed that GPL's strategy of diversifying its business beyond postal operations was contributing to the increase in overheads, making a bottom up approach harder to apply with confidence.

Accordingly, it is considered that a top down approach to assessment of overheads should be adopted, whereby the efficient total level of overhead costs is judged by comparison with appropriate benchmarks.

It was noted that the 2006 Efficiency Review had considered the ratio of overheads to total costs as a relevant benchmark, and that such a ratio does not suggest an undue increase in overheads over time. However it was concluded that this ratio ignores the fact that much of the recent increase in GPL's cost base has been driven by outsourced costs (such as Royal Mail charges and UK conveyance) rather than local direct costs (such as postal operations). If, as suggested by GPL in its own submission, overheads are driven mainly by direct costs, then a simple ratio of overheads to total costs can give a distorted view of efficiency.

For these reasons, it was considered that a more reliable benchmark is the ratio of overheads to direct costs, and such a ratio suggests that overheads have risen significantly to unreasonably high levels, from around 30% at the time of the 2006 efficiency review to around 50% now. It was noted that this approach would suggest a ceiling for 2009/10 overheads of £2.7m.

The second benchmark considered by the 2009 Efficiency Review was the level of overheads forecast by GPL management in 2006, which would suggest 2009/10 overheads of £3.8m. It was considered that under this approach, increases in overhead levels above that benchmark would not be prohibited, but they would need to be justified by reference to a small set of narrowly defined criteria:

- expenditure which leads to a demonstrable improvement in the service quality of postal services;
- expenditure which leads to a demonstrable improvement in the cost effectiveness of front line postal operations; and
- expenditure which is forced on GPL due to factors entirely beyond its control.

Consideration was given to a number of arguments put forward by GPL for increases that met these criteria. Increases relating to property rates and certain reallocated costs were considered reasonable, resulting in revised benchmark of £4.0m, £1.9m below 2009/10 levels. After allowing for inflation to 2010/11, and for the fact that GPL itself forecast a slight reduction in overheads between 2009/10 and 2010/11, this equated to an efficiency saving for 2010/11 of £1.7m in total overheads.

4.2. Responses to the Draft Decision

4.2.1. Postal Operations

GPL accepted that there is further scope for efficiencies within postal operations and agreed to "*embrace the financial target set by the OUR*". However, GPL disagrees with a number of conclusions, in particular in relation to productivity calculations.

4.2.2. Royal Mail charges

In its response, GPL states that:

> *"GPL was fully aware of the DSA rates before agreeing to Royal Mail's proposed charges, contrary to what was suggested in the Draft Decision. GPL had undergone the research and used the DSA rates as a benchmark in negotiations with Royal Mail."*

4.2.3. Retail Network costs

The C&E Department supported the efficiency review's caution over the allocation of the costs of Smith Street to postal users, stating:

> "*the commercial justification for Guernsey Post to provide a stationery outlet at its Smith Street premises is far from evident, especially given that similar outlets already exist in close proximity. The Department concurs that it is essential that the non-core costs related to this outlet are not met by postal customers*".

4.2.4. Overheads

In its response, GPL disputes the DG's assessment of the significant increases in overheads, both in terms of approach and outcome. In its response to the Draft Decision, GPL states that it does not objects in principle to the DG's decision to adopt a top down approach to reviewing overheads but believes that the review has not been satisfactorily undertaken. It believes:

- the bottom up explanations of GPL's costs had not been taken into consideration by the DG;
- different assessment criteria had been used compared with the previous price control;
- DG's failure to consider the source of funding for GPL's diversification activities resulting in the DG understating GPL's allowable cost base in respect of overhead costs for postal activities;
- overstatement of the scope for further efficiencies to be realised, particularly a failure to properly consider the need to manage risk.

GPL set out in its response its rationale for investing in overheads and does not accept that such costs are not being controlled.

Apart from GPL's disagreement, other respondents generally shared the concern expressed by the efficiency review that the increase in overhead costs was excessive.

Healthspan, one of GPL's largest customers, argued that the doubling of overheads in recent years "*hardly represents a cost efficient organisation*", and observed that the decline in traditional mail is due to the changing nature of communications with increasing volumes going electronically, asking "*What has the management of GPO done to react to this fall off in business? What reductions have they made in costs?*"

Another BM stated that it completely agreed that overhead growth has been excessive and must be reduced, and that it is not good commercial practice to increase overheads in a time of contraction of the market (i.e. for traditional non-bulk mail).

A third BM argued that overhead growth is a symptom of a lack of clear strategy while another expressed doubts about GPL's diversification policy and its effects on overheads and management focus, stating "*overhead control seems to have been lost*" and noting that GPL appeared to be adding unnecessary additional managers which added to "*the sense of empire building*". The BM urged the DG "*not to allow BM tariffs to rise to support an inappropriate overhead and business structure unrelated to the running of a commercial and efficient postal service*".

In its response, the C&E Department also expressed concern over the significant increase in GPL's overhead costs.

Another respondent argued that the "*growth in payroll costs, fuelled by generous pay settlements and rising staff numbers*" was bound to have an impact on postal rates. The Guernsey Consumer Group raised concerns that in the light of the rise in overheads against a stated reduction in postal business postal tariffs are being used to fund other purposes.

A number of respondents supported the use of a top down approach to benchmark the efficient level of overheads. One BM calculated that GPL has currently an overhead level of around £2,000 per household per year. It argued that given the size of Guernsey, there could be no real justification to it costing over £5 per house per day and argued that overhead costs should be benchmarked against what is acceptable for the number of households that GPL serves.

The C&E Department stated that it "*shares the OUR's concern with regard to the significant increase in overhead levels, and agrees that steps should be taken to reduce these to absolute levels in real terms that are similar to those at the time of the last review in 2006.*"

A number of respondents highlighted the limitations of the simple ratio of overheads to total costs rejected as a relevant benchmark by the efficiency review. The C&E Department stated *"The Board has considered Guernsey Post's argument that overheads are at the same percentage of total costs as in 2006 and should therefore be accepted. This however ignores the fact that the significant increase in costs since 2006 have been due to the increase in terminal dues charged by Royal Mail i.e. costs that should not generate significant increases in overheads*".

One BM pointed out that the simple ratio, at around 11% according to GPL, seems to make no sense for a very large part of GPL's turnover and cost base, BMs, where according to GPL own public statements "*only about 6% of their total postal costs come from GPL*" – in other words, for that part of the business, overheads incurred exceed those recoverable through prices. The BM estimated that if this anomaly were corrected for the simple ratio for the remaining part of the business would exceed 20%, which it felt was far too high.

The C&E Department supported the efficiency review's reliance on GPL's 2006 forecast as a relevant benchmark, stating:

> "*The Department shares the OUR's concern with regard to the significant increase in overhead levels, and agrees that steps should be taken to reduce these to absolute levels in real terms that are similar to those at the time of the last review in 2006. While there is a need to ensure that Guernsey Post has sufficient resources for it to be able to manage the business efficiently and meet its obligations, the recent increases appear to be beyond those which are essential for the operation of the business and to be of limited value to postal customers.*"

The C&E Department stated further that it

> "*..agrees with the approach that unless increases in overheads can be justified on the basis of their essentiality to the business and the benefit of postal customers they should not be taken into account in determining increases in tariffs*".

4.3. DG's Views

The DG acknowledges GPL's acceptance of the scope for further savings in postal operations and that it does not object in principle to a top-down approach to assessing the appropriate level of overheads the company should be incurring.

GPL's main objection is the manner in which the top-down approach has been applied. As explained in the Draft Decision, outsourced costs (such as Royal Mail charges and conveyance) form an increasingly greater share of GPL's total cost base. It is therefore inappropriate to compare overhead costs with total costs, because overheads are driven to an overwhelming degree by local activities alone. GPL disputes this in its response, but its position is contradicted by its own tariff submission, which explicitly, and in the DG's view correctly, allocates the vast majority of overhead costs in line with local activities. The DG therefore remains of the view that it is more appropriate to compare overhead costs with direct costs and not total costs. The DG's decision on this aspect of the price control decision is set out in section 4.4. below.

4.4. DG's Final Decision

As indicated above, the principal objection raised in respect of the conclusions from the 2009 Efficiency Review came from GPL in relation to the conclusion on overhead costs. The DG believes it is important to clarify the significance of this conclusion to the tariffs proposed in this Final Decision.

Compared with the costs put forward by GPL, the efficiency review identified approximately £2m in efficiency savings in 2010/11, of which £1.6m related to the price controlled postal business, comprising:

- £0.3m in respect of postal operations and retail network costs; and

- £1.3m in respect of overheads (note this figure is lower than the £1.7m identified in 4.1.5 to reflect the proportion of overheads allocated to the price controlled postal business).

However, in view of the fact that this is only a one year price control, and the desirability of smoothing the transition of prices to the new PiP structure, the DG decided not to apply the full savings when arriving at the tariffs in this decision. These tariffs in this Final Decision assume efficiency savings of only £0.8m, around half the level identified by the efficiency review.

Since the £0.3m savings in respect of postal operations and retail network costs have not been disputed, this means that this decision need only assume efficiency savings of £0.5m in respect of overheads. Therefore, GPL's objections would require overhead savings to fall from the £1.3m identified in the 2009 Efficiency Review to below £0.5m before having any effect on the tariffs in the DG's decision.

The DG notes that even if he were to increase the allowance for overhead costs by the entirety of the £0.9m of additional expenditure argued for by GPL, this would only lead to an increase in the allowance allocated to the price controlled postal business of £0.7m, and to a fall in the assumed efficiency savings in respect of overheads from £1.3m to £0.6m. Even in such circumstances, there would be no effect on the tariffs in the DG's decision.

The DG does not therefore propose to conclude further on what basis should be used to determine the appropriate level of overheads as part of the efficiency review for the purposes of this price control decision. The DG considers the issue is best revisited as part of the next price control decision.

DG's Final Decision

The DG will set tariffs based on GPL making efficiency savings in the price control business of £800,000 during the price control period.

5. Down Stream Access

The DG first identified the potential for GPL to achieve savings for BMs by using alternative providers to take advantage of Royal Mail's own Downstream Access ("DSA") tariffs over three years ago, in the 2006 Draft Decision. Three years later, GPL has yet to offer its BMs a finalised DSA based tariff.

5.1. The October 2009 Draft Decision

The October 2009 Draft Decision noted that GPL had presented a number of reasons as to why it had not made greater progress with DSA, namely:

- that DSA does not offer the quality of service BMs require – in GPL's words, "*We are looking at these but there does not at present seem to be any customer prepared to sacrifice a day's service in exchange for a lower price – it's lack of demand rather than lack of an offering;*
- that cost savings apparently available from DSA would be reduced by the cost of the operational changes BMs may have to make to work with a DSA provider; and
- that DSA may create problems with HMRC as such operators would not be covered by the Memorandum of Understanding ("MoU") relating to processing of VAT payments (of which GPL is a signatory).

The DG accepted that there are quality of service differences between the product GPL currently offers BMs and that available through DSA. However, he was not convinced that the difference was significant enough to make it entirely unattractive to BMs, and was concerned that GPL may not have been giving a balanced view of the issues to BMs.

The DG also accepted that DSA would have some cost and customs consequences, but suggested these issues were likely to be manageable. However, he again expressed concern that GPL may not have been giving a balanced view of these issues to BMs.

The DG expressed concern that it was not clear from the information available that GPL had been giving sufficiently rigorous or timely consideration to examining DSA on behalf of its customers as a lower cost alternative to the RM contract, either in its entirety or with respect to specific BMs.

The DG pointed out that he continued to believe that there are opportunities available through DSA for GPL to reduce its costs. He also expressed his concern about the pace at which GPL has progressed this issue since 2006.

5.2. Responses to the Draft Decision

GPL repeated its claim that demand for DSA was limited, stating "*it is our experience that traditionally customers have not wished to pursue DSA*" and claiming that where it had explored opportunities with customers, "*in every case so far the customer has* *not opted to go down the DSA road*". GPL also claimed that the DG had misrepresented its position on the demand for DSA, and that "*GPL does not, as the Director General misleadingly states, believe (or tell its customers) that 'DSA does not offer the level of service bulk mailers in Guernsey require'* ".

While GPL accepted that it could, in the past, "*have been more proactive*", it did not accept that it has not explored DSA properly with those customers who have expressed an interest. GPL disagreed with the DG that it has not shown enough engagement with DSA operators, and stated:

> "*The pace of change, if there is to be any, will be driven by customer needs and GPL continues to work with its customers to develop solutions that meet those needs. DSA has not been the answer for the three companies where we have explored the DSA option*".

The evidence from other respondents is however in sharp contrast to GPL's description of itself as being fully engaged in exploring DSA and being delayed primarily by a lack of demand on the part of BMs.

The C&E Department, having met with representatives of the BM industry, raised concerns that GPL was not in fact sufficiently engaged with BMs, and that demand for DSA may be higher than claimed by GPL. It stated in its response:

- "*It would appear that there has been insufficient consultation between GPL and the fulfilment industry in order for the company to fully understand and meet the latter's needs...*

- *A case in point concerns delivery times for customers receiving their orders, where Guernsey Post appears to have assumed that more rapid delivery times are required than is actually the case for some customers....*

- *The Board is highly concerned that in its public comments Guernsey Post has either misrepresented or failed to understand its customers' needs. In light of the evidence provided by the Bulk Mailers, it would appear that the Guernsey Post has not had effective communication with its main customers which is of considerable concern to C&E Board. The Board believes that Guernsey Post should take immediate steps to improve the channels of communication with its main customers and respond to their needs...*

- *The company's poor communication with the bulk mail sector leads to the question of how well Guernsey Post understands the business models of its main customers who contribute over £20m of its revenue...*"

The responses from Bulk Mailers supported these views:

- Healthspan noted GPL's claim that "*there does not at present seem to be any customer prepared to sacrifice a day's service in exchange for a lower price – it's lack of demand*", and commented "*This was a categorically dishonest statement. Healthspan made it quite clear that they wished to pursue DSA. We do not have a concern regarding an additional day in transit for our* *goods, so J+3 would be acceptable. Guernsey Post has not actively sought to find ways of creating DSA with Healthspan nor have they been able to offer any pricing structure. Their claim at a recent meeting that "there was little interest" from "bulk mailers", was clearly untrue in our case.*"

- A second BM stated in respect of DSA: "*There is a typically 'reactive' approach to GPL's response to this. The assumption that customers do not want a slower service at a lower cost is an outrageous assumption without any clear evidence. A company as insignificant as Amazon already offers a Free Super Saver delivery option with a 2 day slower service. Are they and their customers wrong?! Every service that the GPL has so far delivered to the bulk mailers has been at the request of the bulk mailers. Often these requests for services have taken years of lobbying... Whatever the GPL says there is benefit from downstream access. The bulk mailers have already been using DSA for many years for catalogue deliveries with significant cost savings over GPL and Royal Mail prices.*"

- A third BM stated: "*We are aware that many BM customers feel that for GPL to have approached negotiations with RM without the leverage of a credible DSA alternative was incompetent and has contributed to the unsatisfactory state of the process. We sympathise with this view. We agree with the DG's comments that GPL should have pursued this option much more vigorously.*"

- A fourth BM stated that exploring DSA "*was probably the singular most important task*" for GPL management over the next few years and "*does not seem to have been given the importance and focus it should have*". It stated that quality of service issues were cited by GPL as the main problem with DSA but that nobody from GPL had spoken to them *"to understand if there was an appetite for a cheaper but slower service. A straw poll by the bulk mailers at our last meeting stated there was a demand.*"

GPL accepted that "*there are likely to be potentially significant savings from DSA*", but argued that the DG's calculations are flawed as they are based on out of date traffic forecasts and do not allow for increased costs faced by customers using DSA.

GPL argued that the DG had misrepresented its position on quality of service, and that GPL does not represent its existing BM service as "*clearly a J+2 product rather than a J+3 product"*. GPL also disputed that DSA might provide more robust service levels in the event of industrial action, since that would only be true in the event of localised action as opposed to all-out strikes, and in any event GPL acted to move its mail further down the pipeline when industrial action took place.

GPL also suggested that the DG had understated the customs issues surrounding DSA. However, one BM noted that GPL's approach to resolving the customs issues associated with DSA demonstrated a "*lack of joined-up thinking*" that in discussions GPL had seemed "*relieved*" these issues existed as they "*seemed to get them off the hook*" of providing a viable DSA alternative.

Furthermore, on a number of occasions GPL has mentioned that there might be other obstacles such as in relation to LVCR. However, the DG has been informed by potential new entrants that they have procedures in place to deal with LVCR in a fast and efficient way.

5.3. DG's Final Decision

The DG's conclusion on DSA in the Draft Decision is set out below:

> "*The DG continues to believe that there are opportunities available through DSA for GPL to reduce its costs. He is concerned about the pace at which GPL has approached this issue since 2006 and by BMs' views that GPL is less engaged on this issue than might be expected.*
>
> *The DG has noted the potential savings that could be made by GPL (even after taking account of its reservations). Such savings remain significant. The DG notes that this is a one year price control and that further progress may be made by GPL (or by individual BMs directly) in the period before any further review. The DG would urge GPL to take a more active, leading role in this work for the benefit of its customers.*"

The evidence from the responses received by the DG is that this conclusion is on the whole fully supported by the BM industry. GPL's BM customers appear to be signalling very clearly that their needs with respect to DSA are not being met.

GPL's response appears to widen rather than narrow the gap between its attitude and its customers' needs. On the one hand, GPL objected to the DG's characterisation of its position in the Draft Decision, stating: "*GPL does not, as the Director General misleadingly states, believe (or tell its customers) that 'DSA does not offer the level of service bulk mailers in Guernsey require'* ". On the other hand, as noted in the Draft Decision, GPL explained the lack of progress on DSA by stating: "*there does not at present seem to be any customer prepared to sacrifice a day's service in exchange for a lower price – it's lack of demand rather than lack of an offering*"; a statement described by one BM as "*categorically dishonest*".

The more detailed points raised by GPL, even if valid on their own terms, do not detract from this overall conclusion. Moreover, the DG is not convinced by many of these detailed points. For example:

- The DG's estimates of the savings available from DSA are based on the latest available traffic forecasts supplied by GPL, both in support of its tariff application and specifically in relation to individual DSA opportunities for specific BMs; moreover the estimates do take appropriate incremental costs into account.

- The DG does not agree with GPL's claim that it does not represent its existing BM service as a J+2 product. GPL's own tariff application describes the service quality of this product as "*day of posting plus two, with relevant quality of service targets*".

The DG expects GPL to take immediate steps to improve its communications with Bulk Mailers and more importantly to become more actively engaged in assisting this important part of Guernsey's economy grow. It appears to the DG that the company's understanding of these key customers' needs is not what these customers expect it to be and steps should be taken as a priority to address this.

6. The introduction of PiP

In its May 2009 tariff application to the OUR, GPL indicated that it wished to implement PiP for all mail, including intra Bailiwick mail by 1st April 2010.

GPL stated that the main driver for wanting to adopt PiP was the change in structure and scale of the Royal Mail charges for UK and international mail. According to GPL, based on the existing format profile of postings the expected cost increase in 2010/11 as a result of this new contract could amount to approximately £8.2m (an increase of about 18% on GPL's 2009/2010 total budgeted operating expenditure). However, GPL anticipates that, if it were to introduce PiP for all postal customers in the Bailiwick, some customers might switch the profile of their postings to minimise the impact of the price rises and in that case the increase would amount to £3.8m.

6.1. The October 2009 Draft Decision

In the Draft Decision, the DG proposed to allow GPL to introduce PiP both for social and business customers with effect from 1st April 2010. However, the DG proposed changes to GPL's PiP proposals, namely:

(1) An increase in the thickness of international Large Letters; and
(2) A reduction in the number of weight steps to be consistent with PiP in the UK.

GPL proposed to adopt an adaptation of PiP for International Mail which would reduce the maximum thickness of Large Letters from 25mm to 20mm. The DG noted that GPL wanted to reduce both the length and width dimensions for both International Letters and Large Letters. The DG considered that if GPL wants to introduce PiP it should be consistent with UK formats for this product.

GPL also proposed to introduce significantly more weight steps compared with RM. The DG considered that while it is important that prices reflect underlying costs, and are fair, transparent and understandable to customers, the tariff structure should not create an unnecessary burden due to its complexity. In the Draft Decision, the DG noted that GPL's proposed tariffs would result in very high margins on some products and negative margins on other products, which seems to be at odds with the cost reflectivity principle.

As part of his Draft Decision, the DG therefore proposed to amend the weight steps in line with the RM weight steps under PiP.

6.2. Responses to the Draft Decision

Three different issues were raised in relation to PiP by the three respondents on this issue, namely:

(i) The thickness restriction on international Large Letters;
(ii) The number of weight steps; and
(iii) The timeline to introduce PiP.

Thickness restriction on International Large Letters

Healthspan welcomed the move to adopt PiP but stated that it was concerned that GPL was seeking to adopt a 20mm thickness restriction for international mail rather than the 25mm UK recognized size. GPL had previously been recommending the 25mm thickness to Healthspan and it has committed considerable resource and costs to implement this. It questioned GPL's motivation and views it as a:

> *"cynical and deliberate attempt to restrain our ability to take advantage of PiP savings to the benefit of GPO rather than the customer".*

Number of weight steps

GPL argued that the larger weight steps proposed in the Draft Decision do not accurately reflect the costs charged by RM in respect of each mail type. GPL also argued that it would result in an increased level of cross-subsidy between different mail types which would be inconsistent with the stated aims of the DG and GPL.

Timeline to introduce PiP

One of the BMs stated that the introduction of PiP at such short notice would be very damaging to its clients. This respondent also argued that to introduce PiP for international mail at this stage would also be unnecessary.

6.3. DG's Final Decision

The DG has to exercise his functions (which have been set out in chapter 3) in the manner in which he considers is best calculated to balance his duties as set out in the Regulation Law. In discharging his duties, the DG believes that it is appropriate for customers to pay prices that reflect, as well as reasonably possible, the efficient costs incurred in conveying their postal items. This will help the DG to discharge his duty in relation to ensuring that utility activities are carried out in such a way as best to serve and contribute to the economic and social development and well-being of the Bailiwick.

Cost reflective pricing should encourage GPL to develop more efficient and reliable mail processes and encourage customers to choose between them and pay a reasonable price depending on the service they choose. It also helps to promote sustainable competition. Given the significant increases in Royal Mail costs, the DG considers that PiP would protect the mailers of smaller size items from the cost increases which are associated with larger sizes. It would also provide opportunities for mailers of larger sizes to mitigate the cost increases by switching to smaller sizes where practicable. The DG believes on balance that the introduction of PiP has the potential to be a positive development for postal users based on the information currently before him.

GPL argues that fewer weight steps as proposed by the DG in his Draft Decision would necessarily result in a larger cross-subsidy between different postal users.

However, the DG believes that the number of weight steps proposed by GPL makes PiP too complicated from a consumer's perspective. The DG has to strike a balance between cost reflectivity and ensuring that the tariff structure is sensible from a postal users' perspective.

Having considered all the issues, the DG has decided to increase the number of weight steps for all Public Tariff Large Letters and Packets between 0g and 500g. Under the Draft Decision, the DG included three weight steps from 0 to 500g and as part of his Final Decision the DG had increased this to five weight steps in 100g increments. From 500g onwards the weight steps will consist of 250g increments. The weight step approach only applies to Public Tariff mail. Bulk Mail is subject to straight line pricing.

The DG continues to believe GPL's approach to the thickness of International Large Letters is not justified. The DG is concerned that GPL appears not to have consulted with key customers to identify their needs with regard to this product. From the evidence available to the DG, it appears GPL gave no indication of its plans with regard to a thinner thickness (i.e. 20mm) for this product until the submission of its tariff proposals and there is no evidence that it discussed this issue with customers in the intervening period. In view of this, the DG has decided that a thickness restriction of 25mm for International Large Letters should apply once PiP is introduced.

DG's Final Decision

The DG approves the introduction from April 2010 of PiP based pricing in line with the tariffs and weight steps determines in this Final Decision as set out in Annex A.

7. The ‘Reserved Area’

7.1. The October 2009 Draft Decision

In October 2009 the DG proposed that the Reserved Area (“RA”) in Guernsey should be reduced from the current £1.35 to 65p. The Draft Decision set out the DG’s rationale for the proposal to reduce the RA and invited comments on the proposals.

7.2. Responses to the Draft Decision

GPL’s response to the Draft Decision on reducing the RA focused on the legal vires for the DG to make a decision to reduce the RA. Amongst the specific points raised by GPL was a concern that the DG’s analysis of the impact of reducing the RA was not sufficiently robust to form the basis of a decision to reduce the RA. GPL argued that the DG could not take into account assumed future efficiency savings when undertaking this analysis and that the DG had conducted his analysis by reference to volume forecasts in respect of which there is insufficient assurance that such volumes would in fact eventuate. GPL also argued that the DG had misrepresented its position with regard to downstream access products and that at 65p the RA would not be sufficient to ensure the provision of the USO. In summary GPL argued that the DG’s proposal was beyond his power, unreasonable in all the circumstances and therefore ultra vires.

The C&E Department also responded to the Draft Decision. It stated that:

- the evidence available to C&E indicated that GPL has not considered appropriately consumers’ needs, and in particular has assumed more rapid delivery times are required than is actually the case. This has implications for the value of offering customer’s products based on Royal Mail’s downstream access products;

- When determining the size of the RA it is not just the impact on GPL’s profits that should be taken into account, but the wider impact of reducing the RA on Guernsey and the position of its BMs as a key part of the economy; and

- It was not convinced that in the medium term the continuation of the RA was essential to maintaining an effective universal service, which can best be achieved through efficiencies and more cost reflective tariffs.

A substantial number of responses were received from BMs and their representatives to the Draft Decision. A number of the responses were marked as confidential. Those BMs who expressed a view on the appropriate scope of the RA, either supported the DG’s proposal to reduce the RA to 65p or argued for the complete removal of the RA. A number of reasons were identified to support a reduction in the RA, including;

- a lack of responsiveness to consumer requirements by GPL,
- a desire for more access to downstream access products,

- the need for competition to ensure that Guernsey's postal service remains competitive with other jurisdictions and
- concern at GPL's proposed price increases.

UK Mail and Citipost as potential new entrants to the market both supported a reduction in the RA.

The Policy Council, while acknowledging the DG's right to amend the RA, requested that the DG consider no change to the RA until a more detailed assessment of the implications for the USO is undertaken and the approach to managing competition in the postal market is developed.

Postwatch supported the maintenance of the RA at its current level because it considered that GPL's "social obligation" required some protection against "cream skimming" of profitable opportunities by new entrants. A number of States Deputies responded in general expressing concerns that further competition may negatively impact upon the USO and result in GPL needing financial assistance from the States as a result of competition.

The DG also received over 1700 business reply cards or emails as a result of GPL's public campaign against the DG's proposals. The DG also acknowledges the Facebook social networking site campaign in support of GPL's position.

7.3. DG's assessment

The DG has noted that GPL's response to the Draft Decision did not explain why the continued maintenance of the RA at its current level or at the higher level sought by GPL in May 2009 would better meet the needs of Guernsey and its postal consumers, or indeed better meet the DG's overarching duties and obligations. Instead GPL's comments focused on the DG's analysis of the impact of reducing the RA on the universal service. As discussed further below, the DG considers that the analysis of the potential impact of reducing the RA on the provision of the universal service is both robust and consistent with good regulatory practice. In particular, the DG considers, as noted in section 3.3, it reasonable to make volume forecasts and assume improvements in efficiency when making this assessment and the DG is satisfied that all efficiency assumptions and volume forecasts taken into account by him in his analysis of the impact of a reduction in the RA on the provision of the universal service, are reasonable.

The DG notes the support of the C&E Department for the principle of reducing the RA in the longer term. The DG also agrees that the delivery of future efficiencies by GPL is essential to the continued maintenance of the universal service.

The DG recognises the broad support amongst BMs for a reduction in the RA. Based on information and comments provided by various BMs to the OUR, it seems that this support is partly because there is concern amongst BMs that GPL is insufficiently responsive to its needs and that GPL's proposed price increases may make postal services for BMs in Guernsey uncompetitive compared to other similar jurisdictions. The lack of a Downstream Access offering from GPL appears to be a particular concern amongst BMs.

However, the DG also recognises the concerns of Postwatch Guernsey and others about the need to ensure that any reduction in the RA does not put at risk the important social aspects of the universal service. Moreover, the DG is aware of his duty having regard to the Postal Law and the terms of the States Direction of September 2001 to ensure that any reduction in the RA does not prejudice the continued provision of the universal postal service. The potential benefits for BMs from reducing the RA, together with consideration of the potential impact on the universal service are discussed below. In section 9 the DG deals with the regulation of competition in the Postal Market.

7.4. DG's legal duties

The DG considers that his final decision about the RA must be made having regard to his overarching duties and obligations, which are set out in the Regulation of Utilities (Bailiwick of Guernsey) Law 2001, as follows:

- Protecting the interests of users in terms of price, quality and availability of services;
- Ensuring that services are provided to meet the reasonable demands of the islands;
- Ensuring that the utility sectors underpin the general social and economic prosperity of the islands;
- Facilitating the introduction of effective and sustainable competition into the utility sectors;
- Ensuring that services improve continuously and that new and innovative services can be introduced; and
- Taking account of environmental impact issues.

The DG believes that these overarching duties and obligations provide a strong basis to expect that over time the RA should be reduced.

The fourth duty refers specifically to the introduction of effective and sustainable competition, and a pre-requisite to the introduction of competition is a reduction of the RA. In this regard the DG is also cognisant of the States Direction to him that he:

> *"review and revise the award of exclusive rights from time to time with a view to opening up the Bailiwick postal services market to competition".*

The DG also recognises the importance that competition be sustainable, including being compatible with maintaining the universal service (as in any event required by the terms of the States Direction[18]).

While the DG can meet the first objective with regard to protecting consumers on price issues through the price controls that he sets, effective and sustainable competition is likely to be a better means of achieving the wider goals in this objective. In particular, competition may reveal efficiency savings that the DG has

[18] See chapter 3

not identified as the postal operator finds innovative ways to respond to competitors. Furthermore, it is inevitably difficult for the DG to regulate the quality and availability of services in a way that best meets consumers' needs, as it is consumers through competition who are best placed to signal their service requirements. The experience of other countries is that one of the impacts of competition in the postal sector within those countries has been the development of new services by the incumbent and new entrant postal operators in response to customers' demands.

The DG considers that for the purposes of making the decision about the scope and the size of the RA, the second and third duties are similar in their implications. The DG, as explained in his proposals in October 2009, recognises the importance of postal services to the social well being of the Bailiwick. Equally he is aware of the importance of a vibrant and innovative postal sector to the BMs in Guernsey. The DG is concerned that the price increases that have been sought by GPL may impact on the attractiveness of the islands for BMs. This concern is borne out by comments submitted to the DG from BMs in response to the August Consultation and the October Draft Decision. In particular, mailers may consider relocating to other jurisdictions, such as Jersey or Switzerland, that also enable BMs avail of the LVCR regime.

The DG also believes that reducing the RA could help better meet the fifth objective above, namely to ensure that services improve continuously and that new and innovative services can be introduced. As has been set out in the Draft Decision, the DG is concerned that GPL has been slower than might have been expected in investigating and developing further products based on the Downstream Access products offered by Royal Mail. While these services may not suit all Bulk Mailers in Guernsey because of the speed of delivery, the DG believes the overall interests of the Guernsey economy would be best served if mailers had the choice to use these products. Section 5 of this decision has already outlined Bulk Mailers views which support this position.

While the DG considers that his duties and States' Directions support consideration as to whether the RA should be reduced in scope, he is equally cognisant that any variation in the RA should not prejudice continued provision of the universal postal service.

Any analysis of the impact of a change in the RA on the future provision of the universal service will involve forecasts about the future, which may or may not turn out to be correct. However, in order to carry out any form of forward looking assessment the DG will have to rely on forecasts from the present as inputs to this assessment. The DG considers that this is the best basis on which to assess the potential impact of reducing the RA and such an approach has been adopted by other regulators when faced with similar decisions, such as Postcomm in the UK.

While the DG accepts that the onus is on him to be satisfied that any change to the RA does not prejudice continued provision of the universal service, he does not consider that GPL's argument about the burden of proof for his assessment of the future of the universal service is appropriate.

In its response to the Draft Decision, GPL argues that a decision:

"to reduce the RA is explicitly based upon an assumption that GPL will operate even more efficiently than it currently does, which assumption may or may not come to fruition and therefore there is no guarantee that any efficiency savings will be realised by GPL (even if such savings were in fact presently possible)".

Furthermore, GPL questions the DG's analysis of how changing the RA may impact on the universal service because the DG based his analysis on:

"forecast information based on a range of assumptions as to volumes and costs that the Director General cannot be sufficiently certain will eventuate".

As the DG understands it, GPL appears to be seeking to define a burden of proof that would make it almost impossible to reduce the RA because the DG could never be absolutely certain about future developments.

The DG considers that his overarching duties and obligations, and the States Directions, suggest that the decision must involve an informed balancing of risks, recognising that there can never be absolute certainty about future developments. Indeed Section 2 of the Regulation Law explicitly recognises this balancing exercise. Moreover the DG believes that this approach is consistent with good regulatory practice and has been followed by the EU and countries within the EU that have so far reduced their RAs.

The DG also considers for consistency with his overarching duties and obligations, when assessing the impact of the RA on the ability to provide the universal service, the DG should consider the impact of an efficiently operating GPL. To the extent that there are inefficiencies in the operation of GPL that affect its financial position, these are not directly relevant to assessing whether the universal service can be maintained, but are issues that GPL should address as a matter of urgency. An inefficient postal operator implies that consumers are paying more than they should be for the postal services they receive and hence is detrimental to Guernsey's consumers and to the wider economy.

Moreover, the DG believes that assessing the potential impact of reducing the RA by taking account of forward looking efficient costs is consistent with the approach adopted by other regulators when carrying out similar analysis, again including Postcomm in the UK. It is also notable that the Hooper Report[19] on the future of postal services in the UK noted that for Royal Mail the achievement of future efficiency savings was critical to its ability to operate effectively in a competitive market. In considering what approach would be proportionate and appropriate for Guernsey the DG believes that such international experience is relevant.

[19] Hooper, R. (2008) "Modernise or decline: Policies to maintain the universal postal service in the United Kingdom", accessed at http://www.berr.gov.uk/files/file49389.pdf

7.5. Rationale for amending the RA

The DG has assessed the information provided to him and collected by him with a view to determining whether a reduction in the scope (included products and level) of the RA is appropriate, and if so, what particular changes are appropriate. The DG has set out this analysis in a broad cost benefit framework having particular regard to his overarching duties and obligations under the Law. The DG has had regard to a wide range of information, including information and comments presented by GPL and other respondents to consultations, including BMs, the views of the States, and experience and evidence of the impact of reducing the RA in the postal sector in other countries and states, and in other regulated sectors within the Bailiwick.

When considering evidence from other countries, states and sectors the DG has recognised that all situations are somewhat unique, but considers nevertheless that general trends can often be identified.

The DG considers that the most important consideration when deciding on the future scope of the RA is the impact on postal customers in Guernsey, including social and business (including BMs) users. The DG believes that this focus on postal users is consistent with his overarching duties and obligations. It also means that while the DG must consider the impact on GPL of reducing the RA because of its key role as the universal service provider, it needs to take account of an efficiently operating GPL. The DG does not consider that he has an obligation to ensure that GPL can deliver the universal service irrespective of its level of efficiency.

The potential benefits of competition for the universal service

The Hooper Report, an independent review of the UK postal sector, was undertaken to consider the potential policies needed to maintain the universal postal service. It concluded that postal operator competition can support the universal service by:

- encouraging cost reductions by the universal service provider and greater efficiency; and
- encouraging innovation in the products offered. This can create further revenue streams that are supportive of the universal service.[20]

The report did go on to note that while competition can be beneficial for consumers, there are also some risks. This is because competition can reduce the revenue available to support the universal service and some forms of competition can be inefficient if they take advantage of the constraints imposed on the universal service provider. However, the report concluded that these risks were manageable.

The issue of liberalisation and efficiency was also examined by Frontier Economics in 2002 in a report for Postcomm.[21] This report found:

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[20] Hooper, R. (2008) "Modernise or decline: Policies to maintain the universal postal service in the United Kingdom", at p.95, accessed at http://www.berr.gov.uk/files/file49389.pdf

[21] Frontier (2002) "The impact of liberalisation on efficiency: a survey", accessed at http://www.psc.gov.uk/postcomm/live/policy-and-consultations/documents-by-date/2002/frontier.pdf

"significant empirical evidence to support the proposition that liberalisation leads to greater efficiency in both non-postal and postal sectors".

The European Commission in introducing the latest postal directive also considered the impact of full market opening on the provision of the universal service. In their view full market opening was expected to create a better alignment between the services provided, the needs of customers and the willingness of those customers to pay for the services provided.[22] In addition, it was expected that market forces would contribute to the universal service being provided in a more efficient manner. The European Commission report went on to note that market forces alone may not be able to sustain the universal service, rather universal service providers ("USPs") should be given a greater degree of commercial freedom.

In assessing the potential benefits of competition the DG recognises that the nature of competition is such that the outcomes can be uncertain. In sectors that have been heavily regulated and dominated by a monopolist it is often very difficult to predict how the services and prices will develop over time in response to the introduction of competition. For example, while technological developments have been an important driver of change in telecoms services around the world, the choice and quality of service that have developed since competition was introduced was not envisaged by many people at the time that telecoms markets were opened to competition. The DG considers that at its heart competition is about serving the interests of consumers as well as possible because where companies in a competitive market do not meet consumers' needs, those consumers may choose an alternative provider. This continuous threat is what drives companies to offer better prices (through improved efficiency) and better quality of service. This is essentially what has happened in mobile and fixed line telephony and there is ample evidence of this from the Guernsey telecoms market since competition was introduced. It is worth noting that C&W Guernsey has a USO obligation which it provides even though it is in a fully liberalised market.

Furthermore, the DG considers that while regulation can be partially effective in driving companies to improve their efficiency, it is unlikely to be as effective as competition. This is partly because incentive based regulation (such as operated in Guernsey) includes the problem of asymmetric information where the regulated company knows much more about what can be achieved regarding efficiency savings than the regulator. While the opportunity for the company to earn additional revenue by out performing the regulatory price control can be an important driver to make additional efficiency savings, competition is likely to be a more powerful driver because the failure to make efficiency savings in a competitive market is much more damaging for a company than in a regulated monopoly situation.

GPL has argued in response to earlier consultations that it can provide the range of services that mailers in Guernsey require, and therefore it is not necessary to introduce competition to ensure that consumers benefit from a range of innovative services.

[22] European Commission (2006) "Prospective study on the impact on universal service of the accomplishment of the postal internal market in 2009", at p.5, accessed at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2006:0596:FIN:EN:PDF

GPL also argued that if companies priced below GPL it would amount to predatory pricing.

The DG considers that if GPL is confident that it can meet the needs of all consumers in Guernsey, it is unclear why it would be concerned about a reduction in the RA as it would appear confident that it could offer services that would be sufficiently attractive for consumers not to be tempted to switch to competitors, and therefore it would continue to generate more than sufficient revenues to provide the universal service. The suggestion that new entrants could price in a predatory manner seems particularly unlikely given that a pre-requisite for predatory pricing to be successful is a strong market position that would allow a competitor to be driven out of the market such that losses while pricing in a predatory fashion could be recouped subsequently. Moreover, it seems to the DG extremely unlikely that a new entrant to Guernsey would have this ability, not least while GPL continues to have a significant RA.

Although GPL believes that it can meet the needs of all consumers in Guernsey, the information and comments which the DG has received through consultation responses and discussions with BMs strongly indicates that this view is not shared by key customers of GPL. While many BMs are reluctant to publicly set out their concerns given the need for an ongoing relationship with GPL the DG believes, from submissions made to him, that these mailers would like a wider choice and range of services than GPL is currently offering. Indeed many BMs have suggested to the DG that the RA should be abolished.

The DG has set out previously that he is concerned that GPL has been slow to investigate and introduce products that use Royal Mail's DSA products. While these products may not suit all mailers in Guernsey because of the timing for deliveries to the UK, the nature of mail being posted into the UK is such that some BMs may prefer a slower service than currently offered by GPL if that led to a more competitive price. The responses received from BMs to the Draft Decision support this view.

There is also strong evidence from the UK that many BMs prefer reliability of service and lower prices to speed of delivery. This illustrates that competition can often be as much about the variety and choice of services, with consumers benefiting from having a range of price-quality combinations. Furthermore, the offering of a greater variety of services has the potential to grow segments of the mail market. The DG regards the lack of progress by GPL to offer services linked to Royal Mail's Downstream Access products in addition to its current products as evidence that competitive pressures on it are not currently sufficient.

As the DG has already noted, the postal sector in Guernsey faces competition from other jurisdictions, such as Jersey and Switzerland that can also meet BMs needs with regard to the LVCR regime. Given that Jersey does not have a RA it is particularly important to ensure that Guernsey's competitive position with regard to vibrant postal services is enhanced not undermined. More competition for GPL is likely to sharpen its product and service offerings, thereby increasing the attractiveness of Guernsey as a location for businesses using a significant amount of postal services.

Whether such competition materialises will be down to individual operators assessing whether the market is attractive enough for them. Nevertheless, the DG recognises that the threat of entry can be an important competitive constraint on a company, and even if a reduction in the RA does not lead to significant market entry, the threat of such entry may nevertheless act as a driver for GPL to improve its efficiency and competitive offerings.

While a reduction in the scope of the RA is likely to directly benefit BMs, the DG believes that indirectly it could also have significant benefits for all postal customers. In particular, given the integrated nature of GPL's business it is likely that when making efficiency savings in response to a reduction in the RA at least some of the benefits should be received by social and other business postal customers over time, e.g. any reductions in overheads. The 2009 Efficiency Review illustrates that improvements in the efficiency of GPL over recent years have been less than anticipated. The DG believes that a reduction in the RA is likely to act as a significant stimulus to GPL making further efficiency savings.

7.6. Changes to the Reserved Area

The DG considers that the views and information discussed above support his consideration of a reduction in the RA. While these benefits would probably be primarily focused on BMs, it is likely that all postal consumers would benefit from improved efficiency by GPL and better services.

Given the States' Direction that the RA should be set "(...) *to the extent that such exclusive right is necessary to ensure maintenance of the USO (...)"* the DG considers it inappropriate to maintain a RA at a level which is higher than is necessary for the maintenance of the USO. The DG has therefore decided to reduce the RA from £1.35 to £1.00. Furthermore, the DG considers that packet products are a relatively discrete product set. Given GPL's proposed tariff increases, it has become clear to the DG from his dialogue with BMs that these mailers are particularly interested in exploring alternative providers for packet services. The DG considers that the greatest benefits from changing the scope of the RA may therefore be concentrated on packet products. The DG considers the implications of this RA below.

7.7. International Experience

The DG is aware that the Guernsey postal market has particular features which need to be taken into account in making comparisons with other jurisdictions. Amongst other factors, these particular features include:

- **The relationship with postal operators in the UK:** It is estimated that less than 40% of mail is forecasted to be originated and delivered in the Bailiwick and this level is declining. This means that GPL's relationship with a postal operator such as Royal Mail is very important.
- **Guernsey's geography:** The Bailiwick encompasses a number of islands and GPL is required to provide universal services to the inhabitants.
- **The customer base:** The nature of the customer base may be different to other postal service providers. In particular, Guernsey has more small business and residential customers than many other postal operators. For

- **The nature of the cost base:** All USO providers in the postal sector have relatively lumpy cost bases because the need to maintain a capability to deliver services next day creates a requirement for an extensive network of offices, equipment and people, which do not vary that much with volumes handled. Arguably the fixed nature of costs is exacerbated in a small island like Guernsey because facilities such as the mail centre are broadly fixed in size and cannot be materially reduced in size when volumes change. However, as discussed later this impact is partly mitigated by the more variable nature of conveyancing costs to the UK and Europe, and the charges levied by Royal Mail.

Nevertheless, an examination of postal markets in other jurisdictions can provide useful evidence for appropriate approaches to regulating the postal market in Guernsey. In particular, examining postal markets across Europe has found that reducing or removing the RA for a universal service provider (USP) does not prohibit the USP from being profitable or from providing a high quality service to customers. Furthermore, there is a lot of evidence that liberalisation of postal services leads to more varied products for consumers and potentially increases in the quality of service offered. The DG recognises that experiences do vary from country to country and has exercised care in drawing conclusions from international experiences. That notwithstanding, the DG considers that general trends can be included as a relevant consideration in the overall assessment as to what is appropriate for the Bailiwick and GPL.

The DG has not focused extensively on examples from outside the postal sector. He notes that utility sectors including energy and telecoms provide a range of examples of how competition can lead to improved quality of service and choice for consumers. While the DG recognises that there have been some difficulties with customer service in more competitive markets, such as mis-selling of energy products, the question is always whether the benefits of competition have outweighed any issues that have arisen.

At the present time about 57% of the EU/EEA postal market is being provided without a RA.[23] In answer to concerns about the impact of market liberalisation, a recent report by WIK Consult for the European Commission concluded that:

> *"There is no evidence that elimination of the RA has led to a decline in the quality of the universal service, if anything, the contrary appears to be the case".*[24]

The WIK Consult report further noted that concerns about a rapid decline in universal service following liberalisation due to the potential for 'cream skimming' have not been borne out.[25] It stated:

[23] Estonia (2009), Finland (1991), Germany (2008), the Netherlands (2009), Sweden (1992) and the UK (2006).
[24] WIK Consult (2009) "The Role of Regulators in a More Competitive Postal Market", p. 93, accessed at http://ec.europa.eu/internal_market/post/doc/studies/2009-wik_regulators.pdf

> *"concerns that liberalisation would lead to a rapid decline in universal service due to widespread 'cream skimming' by new entrants have proved unfounded.*"

Market liberalisation is continuing at the European level with full market opening to be achieved in 95% of the EU letter market (by volume) by 2011. The remaining 5% may postpone market opening until 2013.

In a separate study commissioned by the European Commission it was reported that in most Member States where letter markets have been substantially opened, competitive delivery services have developed. In many cases, removing or reducing the RA has promoted modernisation by incumbent postal operators which has the effect of improving the efficiency of postal operations and the reliability of the services provided. A number of national postal operators have become more competitive and more profitable as a result.[26]

In Annex B, the DG sets out some further details of the approach taken in other jurisdictions and the outcome for the postal operators. As well as illustrating the compatibility between liberalisation and successful postal operators, these examples also illustrate that competition has in many countries driven innovation and choice for consumers.

7.8. Assessing the Impact on the USO of reducing the RA

The DG is cognisant that, having regard to the terms of the States' Direction to him, any reduction in the RA should not prejudice the continued provision of the universal postal service. Accordingly, considerable effort has been employed by his Office to examine the potential impact of a reduction in the RA on GPL's ability to continue to provide the universal postal service.

The DG recognises that in theory the removal of the RA could have an impact on the provision of the universal service. However, the DG does not consider that there is an automatic link between a reduction in the RA and an impact on the universal service.

If a reduction in the RA leads to some mailers choosing providers other than GPL then there can be a negative financial impact on GPL because it has a relatively high fixed cost base to provide the universal service. However, the threat of competition and the potential for actual competition from a reduction in the RA is likely to have dynamic effects through driving more efficiency in GPL's operations, offering new products and potentially growing parts of the mail market. So it is important to recognise that an assessment of the link between the RA and protecting the universal service is a complex and dynamic relationship. This view is in line with the Hooper Report referred to earlier in this section which noted that one of the benefits of competition was that it encouraged postal operators to innovate with new products'

[25] WIK Consult (2009) "The Role of Regulators in a More Competitive Postal Market", p. 92, accessed at http://ec.europa.eu/internal_market/post/doc/studies/2009-wik_regulators.pdf
[26] ITA Consulting and WIK Consult (2009) "The Evolution of the European Postal Market since 1997" at p..192, accessed at http://ec.europa.eu/internal_market/post/doc/studies/2009-wik-evolution_en.pdf

and that these new products may increase the revenue streams available to the USP.[27] Given any such new products (and the revenue from them) are hard to predict at this time, the DG's assessment has not made any allowances for such products contribution to support the provision of the USO.

Furthermore, GPL has a lot of advantages that a new market entrant would struggle to easily and quickly replicate, including an established brand, a well developed infrastructure, links with many customers, access to the HMRC MoU for customs clearance and links with postal operators in key countries for the delivery of mail from Guernsey. In the DG's view, these advantages mean that it is far from self evident that new entrants could easily and quickly take significant market share from GPL if the RA was reduced in scope.

In order to assess the potential impact of changes to the RA the DG has assessed the potential impact of changes in the RA on the financial position of GPL. From this analysis it is possible to consider what, if any, increase in the prices of other postal services may be required to ensure that the universal service continues to be provided in the event GPL loses significant volumes of mail.

The nature of the modelling was explained in the October 2009 Draft Decision, but for completeness we have set out again the main elements of the modelling:

- Forecasts of future volumes for products are based on GPL's forecasts, although there is the ability within the model to run some alternative scenarios using volume forecasts provided by some large mailers.
- The costs provided by GPL are modelled and allocated to products. There is the functionality within the model to consider the impact of the efficiency review.
- The model estimates the net revenue that GPL would lose if volume from reducing the RA migrated to new entrants. To estimate the impact on net revenue the model assumes that sea conveyancing costs together with fees paid to Royal Mail are not incurred by GPL if volumes migrate to other providers. The constraint in the model is that GPL should retain to the level of profitability assumed before the RA is reduced, so there is an implicit cushion (although appropriately reflecting GPL's risk adjusted cost of capital) in the model before a reduction in the RA would lead to GPL being unprofitable.
- An estimate is made of the increase in GPL's other postal tariffs that would be required to fund the universal service to compensate for the loss in net revenue under each scenario. A uniform price change across all products is assumed and no adjustment for any price elasticity effects is made.
- The scenarios used generally assume that some of the volumes outside the RA which can switch to a new entrant will do so.

[27] Hooper, R. (2008) "Modernise or decline: Policies to maintain the universal postal service in the United Kingdom", at p.95, accessed at http://www.berr.gov.uk/files/file49389.pdf

Description of scenarios

As mentioned in the Draft Decision, the scenarios were built having in mind that they should be:

- forward looking;
- credible;
- sufficiently different to enable stress testing; and
- based on the best available information.

This criteria, based on the best available information using the information provided by GPL, Bulk Mailers (BM) and Large Volume Mailers (LVM), was used to build three reference scenarios, a base scenario (the most likely scenario), a pessimistic scenario, and an optimistic scenario:

a) Base scenario – For any BM/LVM who has been proactive in demonstrating its interest in moving to alternative providers if they became available, the scenario assumes that all its volumes outside the reserved area are lost.
b) Pessimistic scenario – It is assumed that approximately 15% additional net revenue will be lost in relation to the net revenue potentially lost in the base scenario. Behind this scenario is the possibility of other BM/LVM following the BM/LVM identified in the base scenario above.
c) Optimistic scenario – It is assumed that approximately 15% less net revenue will be lost in relation to the net revenue potentially lost in the base scenario. Behind this scenario is the possibility that some of the BM/LVM identified in the base scenario above may effectively not change provider, despite having signalled interest at an early stage.

It is important to note that this sensitivity analysis is based on the assumption that the only short-run avoidable costs are Royal Mail charges and the costs of Sea Conveyance. Hence, the analysis does not take into account that if significant volumes were lost other categories of costs such as air conveyance, operations payroll costs and overheads would in all likelihood also be reduced.

In addition to considering GPL's demand forecast, the DG has also, as part of the sensitivity analysis, considered the forecasts provided from BMs where they were available. The BMs' own forecasts differ in two respects:

- the forecast volumes differed from GPL's forecasts; and
- the product mix differed.

The three main scenarios were run for both the approaches: using exclusively GPL's forecast, and using BMs' forecasts where available along with GPL's forecasts. The table below summarizes the potential net revenue lost from each scenario:

Table 1 Potential net revenue loss under alternative scenarios

	Potential net revenue loss	
(£000)	GPL demand forecasts	GPL & BM forecasts
Base scenario	£1,515	£1,237
Pessimistic scenario	£1,721	£1,443
Optimistic scenario	£1,300	£1,023

(Source: GPL 2009 Price Control BPM, OUR, December 2009; *Note: "GPL demand forecasts" refers to the demand forecasts submitted by GPL in the BPM. "GPL & BM forecasts" refers to "GPL demand forecasts" as adjusted for demand forecasts provided to the OUR by a number of BMs)*

In building the demand forecast scenarios and assessing its impact against the changes in net revenue the following assumptions were adopted:

a) Non price controlled products are kept unchanged through the sensitivity analysis. This means the inputs for these postal products, both volumes and tariffs, are those proposed by GPL in its submission;
b) Inward remains unchanged through the sensitivity analysis;
c) An amendment to GPL's forecast for a lump sum decrease in volumes (which was its attempt to reflect a decrease in demand due to the impact of higher tariffs). The DG has based his assessment on a more informed approach to assessing individual BMs' likely changes.

Results from sensitivity analysis

The base scenario is built using the best available information, under which part of the demand forecasted volumes outside the RA is assumed to move to alternative providers. As mentioned above, removing these volumes from GPL's business would correspond to a loss of £1.5m in net revenue, using GPL's demand forecasts. The table below presents the impact of the base scenario on GPL's financial position:

Table 2 Base scenario – Impact in GPL's overall Business profitability

(£000)		Final Decision	Base Scenario	Variation
Revenue		54,737	39,911	(14,826)
Opex				
	RM charges	(30,378)	(17,995)	12,381
	Sea Conveyance	(1,756)	(827)	929
	Air conveyance	(3,198)	(3,198)	-
	Overheads	(4,077)	(4,077)	-
	Other Opex	(11,887)	(11,887)	-
	Total Opex	(51,295)	(37,984)	13,311
Depreciation		(1,189)	(1,189)	-
Profit		2,251	737	(1,515)

(*Source:* GPL 2009 Price Control BPM, OUR, December 2009)

The table above shows that if GPL were to lose around £1.5m of its net revenue (which is approximate to the loss of 11.5m of its volumes), the revenue coming from the tariffs set out in this Final Decision still provide a profit of £737,000 in the year ending in March 2011.

The pessimistic and optimistic scenarios enable sensitivity analysis around the base scenario. By using these two scenarios, the DG's analysis shows that even if GPL were to lose some of its volumes to potential new competitors, its overall business profit would still be kept at a level between £531,000 (in the pessimistic scenario), and £951,000 (in the optimistic scenario). These profit levels assume GPL does not take measures to react to competition, such as focusing more closely on its cost base. This range for the profit level of GPL provides an assurance as to the sustainability of the USO. Under this analysis, GPL's is forecast to be profitable thereby ensuring that at this time no further action is required to fund the USO. Further it shows that there would be no requirement for the States, as shareholder, to have to bail out GPL as has been claimed.

While no increase in tariffs is required at this time to sustain the funding of the USO, in the event of a shortfall such that tariff increases are required, the DG has assessed whether such increases would impact upon the affordability of the postal service. The DG has assessed what level of tariff changes would be necessary to maintain GPL's level of profitability prior to the loss of any net revenue. Based on the DG's assessment, to provide GPL with the level of net revenue lost under the analysis above, the DG estimates that tariff increases of between 3.8% and 5.2% would be required (based on the tariffs set out in this Final Decision). The DG believes that even with such increases postal services remain affordable.

It should be noted that the threat of competition and the potential for actual competition from a reduction in the RA are likely to have dynamic effects through driving more efficiency in GPL's operations, offering new products and potentially growing parts of the mail market. These are not taken into account in the analysis above, but then the DG would expect to take account of such dynamic benefits in assessing any future tariff increase requests. The DG would also need to be satisfied that GPL is operating as an efficient postal provider.

The DG has not assumed that all BMs with volumes outside the RA will switch to new competitors. It is likely that the reduction to the RA will mean that most BMs will continue to have volumes both inside and outside the RA. Therefore they will still need to use GPL for a range of products. If they choose to switch non-RA mail to another provider they will have to incur additional transaction costs to deal with two providers. It is not clear whether all BMs will be prepared to incur these costs to switch only part of their mail. Evidence about mailers' willingness to split mail between different providers is mixed from other countries that have introduced competition, although there is evidence that for sufficient price savings mailers are prepared to do this.

The analysis is also conservative in that it has a narrow definition of variable costs. While the model assumes that sea conveyancing costs together with Royal Mail's charges will vary with volume it is possible that GPL may also be able to make cost savings through reduced over time, overhead and other variable costs if volumes reduced. Were such cost savings to materialise it would reduce the impact on net revenue of any loss of volume from a reduction in the RA.

The DG therefore believes that his analysis is a reasonable attempt to consider the potential impact on the USO of changes to the RA.

The DG has also considered how other regulators have approached assessing the impact of opening markets to competition on the provision of universal services, and more generally how regulators have assessed the financial impact of regulatory decisions on universal service providers. This is discussed further in the annex to this document, but the DG considers that his modelling is at least as thorough as that undertaken by Postcomm when it set Royal Mail's 2006 price control[28] and may go beyond previous analysis undertaken by Postcomm when it opened the UK market to competition.

In conclusion, the DG is satisfied that the proposal to amend the RA in the manner now being determined will not prejudice the provision of the USO.

7.9. DG's Final Decision

The DG believes that the evidence to support a reduction in the RA is strong in the context of his overarching duties and obligations, and the States' Directions. In particular, the DG considers that there is a genuine prospect of customers benefiting from a reduction in the RA over time, particularly through improved choice and better

[28] "Royal Mail Price and Service Quality Review, Final Proposals for Consultation", Postcomm, December 2005.

efficiency from GPL. The DG has carefully considered the representations made by GPL regarding the potential legality of his decision, and believes that the analysis set out in this paper shows that he has carefully considered the potential impact of reducing the RA on the universal service. Therefore, he is satisfied that a decision to reduce the RA is legally robust.

In assessing the level of the RA, the DG has been informed by the analysis undertaken on this issue. In the Draft Decision, the DG had proposed a RA defined by price only (i.e. 65p). Having considered the responses to the Draft Decision, he believes there is merit in redefining the scope of the RA to refer to product as well. Therefore he has determined that the RA shall be set such that GPL will have a RA for all items below £1.00 but exclude all packets[29]. The DG believes this definition will provide greater certainty to BMs and potential competitors to GPL of the exact market that is open to competition.

As can be observed in the table below the impact of this revised definition means that approximately 70% of GPL's volumes are within the RA and GPL retains 58% of its net revenue. This compares to 69% of volumes and 53% of net revenue under the Draft Decision proposals.

Table 3 Volumes and net revenue

(000)	**Total**	**Inside RA**	**%**
Volumes	65,568	46,195	70%
Net revenue	19,145	11,054	58%

(Source: GPL 2009 Price Control BPM, OUR, December 2009)

DG's Final Decision

The DG will set as reserved services all items which are not postal packets and which are provided for a consideration of less than £1.00. Such services may only be provided by Guernsey Post. All other services are non-reserved services (including all packets) are open to competition. For the purposes of the reserved services definition, a postal packet is an item with a length over 353mm OR a width over 250mm OR a thickness over 25mm OR a weight over 750g.

[29] A Packet is an item with a length over 353mm OR a width over 250mm OR a thickness over 25mm OR a weight over 750g.

8. The Tariff Structure from April 2010 onwards

8.1. The October 2009 Draft Decision

In the October 2009 Draft Decision the DG proposed a number of adjustments to GPL's proposed Public Tariffs to:

(1) reflect the efficiency savings which were identified as a result of the 2009 Efficiency Review of GPL; and
(2) make the tariffs more cost reflective.

The DG's main approach to determining the tariffs was to conduct a margin analysis. The DG noted in his Draft Decision that a number of tariffs proposed by GPL, especially Public Tariffs, had very high margins e.g. up to 60 per cent. Furthermore, there were also a number of proposed tariffs with negative margins, e.g. loss making. The DG considers that it is therefore not realistic to assume that GPL's proposed tariffs were cost reflective and it is clear that there was a need for the DG to make a number of adjustments.

8.2. Responses to the Draft Decision

In its response to the Draft Decision and subsequent dialogue with the OUR, GPL opposed the DG's proposed tariffs:

(i) because they take into account 'potential' efficiency gains which GPL disputes;
(ii) they are not cost reflective in GPL's view; and
(iii) they create arbitrage opportunities between the Bulk Air tariff and the Public Tariff in certain weight steps.

GPL also raised an issue in relation to the Bulk Air tariff, stating that it was too low and that its narrative submission on which the DG relied was not in line with its submission in the BPM.

A number of BMs argued that the GPL proposed price rises are likely to have a significant impact on their business and that they believe GPL does not seem to have considered sufficiently the effect of these price increases on their business. Many BM respondents referred to GPL's statement on the GPL website that:

> *"Of course bulk mailers want to keep their costs down. We work with them every day to help them achieve that. But the reality is that postal costs are only part of their costs and are frequently passed on to the customer. Only about 6% of their postal costs come from Guernsey Post, whilst 94% comes mainly from Royal Mail charges and conveyance costs. What keeps the bulk mailers on the island is lack of VAT, lower taxation and low labour costs. No bulk mailer will be making a relocation decision based on postal charges".*[30]

[30] http://www.guernseypost.com/about/OUR/Our-Views-on-the-Regulators-Draft-Decision/ (11 November 2009) (This link is no longer active as this page has now been removed by GPL)

BM's have characterized this statement as misleading and misrepresenting the BM industry in general. They pointed out that they operate in a highly competitive market and any increases would have to be absorbed by their businesses. They also pointed out that whilst they benefit from LVCR and tax benefits through being based in Guernsey, other jurisdictions have the same advantages and hence GPL's contention that BM would not leave the island due to postage increases is incorrect.

Healthspan, one of the largest BMs, points out:

> *"The GPO has been complacent in the belief that DM [direct mailers] will simply stay in Guernsey for the foreseeable future. This is not correct. As far as Healthspan is concerned, we will keep the head office in Guernsey, but our postings will be based where the prices are most competitive so that Healthspan can continue to grow and flourish as a Guernsey tax payer and employer. The need to use GPO does not exist. We can ship our goods, which are made in Switzerland, Germany, the UK and India directly into a dispatch centre anywhere. Jersey is the closest. We would prefer to stay in Guernsey but only if the GPO can be efficient and competitive which currently it is not. The same applies to all of our Island's DM industries except perhaps for flowers and those that cannot move will cease to exist."*[31]

In its response, the C&E Department shares the BMs concerns and is concerned that GPL fails to take account of Guernsey's actual circumstances (e.g. land and labour scarcity, introduction of a minimum wage etc.) and that it also fails to consider the real threat of competitor jurisdictions and how individual businesses can remain competitive in their markets. It concludes:

> *"Most significantly the company's [GPL] poor communication with the bulk mail sector leads to the question of how well Guernsey Post understands the business models of its main customers who contribute over £20m of its revenue."*[32]

One large BM urges the DG not to allow BM tariffs to increase to support an inappropriate overhead and business structure unrelated to the running of a commercial and efficient postal service. Another BM is concerned that GPL management may have been more focused on diversification rather than Royal Mail contract negotiations. Yet another BM argues that the proposed tariffs will have a significant impact on margins and that its business will suffer the full brunt of the cost increases and that this will impact on their viability, profitability, growth, employment and consequently tax revenue.

Respondents arguing in favour of price increases

One respondent argued for the DG to accept GPL's proposed tariff changes as otherwise it might result in a massive reduction in GPL's income.

[31] Healthspan response to the Draft Decision, p.4
[32] C&E response to the Draft Decision, p.6

Discounts

The C&E Department stresses that in its view there has been poor communication between GPL and its main customers, e.g. BM. It raised as a specific issue that GPL has made no reference to the fact that the tariffs specified are the maximum that can be charged and that volume discounts can be granted provided that it is done on a fair and equitable basis ensuring consistency of treatment between different customers.

One of the BM also argues that discounts should be provided by volume by GPL to reflect the amount of work and administration which BM undertake on behalf of GPL.

8.3. Approach to determining the tariffs

Cost reflectivity and transparency

The DG considers that it is important for tariffs to be cost reflective as this ensures that both postal users and GPL get the right price signals. However, the provision of a USO by its nature means that there will be some degree of cross-subsidy between different postal users as otherwise the service would no longer be at a uniform price throughout the Bailiwick.

The DG has therefore had to strike a balance between cost reflectivity and ensuring that tariffs are reasonable and transparent and not overly complex.

The DG has made a number of changes to the Public Tariff to ensure that the Public Tariff is not lower than the Bulk Air Tariff. This has meant a number of increases in the Public Tariffs as he was not able to reduce the Bulk Air Tariff due to the low margins for this product. The Bulk Mail tariffs are the tariffs proposed by GPL in its narrative submission to the DG.

Discounts

A number of respondents raised the issue of discounts either in their written response to the Draft Decision or in their on-going dialogue with the OUR. The DG's view has always been that GPL has the flexibility to offer discounts as long as it ensures that they adhere to licence condition 18 in Part III of its Postal Licence, i.e. discounts shall be:

- (i) Non-discriminatory;
- (ii) Transparent;
- (iii) Cost justified; and
- (iv) Objectively justifiable.

In its submission GPL proposed discounts for PPI and Franked Mail. The DG has allowed a 3 per cent discount on average for these types of mail compared with the Public Tariff in line with the discount proposed by GPL. This discount has been reflected in GPL's revenue allowance based on the data provided by GPL.

The headroom allowed by the DG in his tariff determination is sufficient to enable GPL to consider offering discounts. If GPL wants to give any other discounts it will have to submit a proposal to the DG for his approval in which it sets out how it meets the above criteria. If the DG after consulting with GPL and stakeholders is satisfied that the discount scheme meets the criteria he may approve them. If he is not satisfied that this is the case he may issue a direction requiring GPL to adjust the discount scheme so it conforms with its licence obligations.

8.4. Changes between the Draft Decision and Final Decision tariffs

The DG has carefully considered the responses to the Draft Decision and the information further provided to him by a number of parties. This has resulted in a number of adjustments to the tariffs proposed in the Draft Decision.

Bulk Air Tariff

The DG has adopted all the Bulk Mail tariffs (air and sea) as proposed by GPL in its narrative submission to the OUR. Since the publication of the Draft Decision, GPL has argued for a higher Bulk Air tariff as according to GPL the tariff proposed in its narrative submission was incorrect and in effect loss making. GPL also argued that if it had known that the DG intended to revise the RA it would have proposed alternative pricing). The DG notes that GPL did not ask for any reduction in Bulk Sea tariffs in spite of the relative high margins.

The DG has decided to adopt the Bulk Air and Bulk Sea tariffs proposed in the Draft Decision. The DG still has a number of issues with GPL's approach to cost allocation. He accepts that there seem to be profitability issues with at least part of the Bulk Air tariff as it seems to have negative margins in parts. However, profitability is directly linked to costs and given the uncertainty about how GPL has allocated costs to this and other products, the DG considers it inappropriate to make any changes to this tariff as part of the Final Decision given that he adopted the tariff GPL requested in its narrative submission.

It is important to note in this context that one of the main cost drivers of Bulk Air is conveyance costs. The DG has allowed GPL's proposed expenditure for a second aircraft in full. This was not subject to a detailed assessment given the fact that this is only a one year price review. However, the DG considers that this might need to be further examined as part of next year's review, including how much actual expenditure compared with forecast expenditure has been incurred. It is possible that the outcome of such a review might result in a rebalancing between Bulk Air and Bulk Sea tariffs.

Another issue raised by GPL in relation to the Bulk Air tariff in the Draft Decision was that in certain parts of a number of weight steps a BM would be better off using the Public Tariff rather than the Bulk Air tariff. The DG notes that this would depend on the average weight of the mail of a BM and hence that in practice this is not a clear cut issue. However, the DG has decided to address this issue through adjustments to the Public Tariff rather than the Bulk Air Tariff.

Public Tariff

As part of his Final Decision, the DG has made a number of changes to the structure and the level of the Public Tariffs compared with the tariffs proposed in the Draft Decision. The DG has decided to introduce *two* additional weight steps for postal items between 0g and 500g:

Table 4 Adjustments to weight steps

October Draft Decision	December 2009 Final Decision
0 – 100 g	0 – 100 g
100 – 250 g	100 – 200 g
	200 – 300 g
250 -500 g	300 – 400 g
	400 – 500 g

Above 500g the weight steps remain the same as in the Draft Decision, e.g. 250g increments. As a result of the two additional weight steps for Large Letters and Packets, the DG had to make some changes to the Public Tariff. As far as possible this has been done in a revenue neutral way, i.e. the increase in weight steps is not expected to result in materially more revenue for GPL.

Table 5 Adjustments to Local Public Tariff due to weight step change[33]

DRAFT DECISION			FINAL DECISION		
Format	**weight step**	**Price**	**Format**	**weight step**	**Price**
LL	250-500 g	68	**LL**	200-300 g	**56**
	500-750 g	110		300-400 g	**66**
				400-500 g	**78**
				500-750 g	110
P	0-100 g	70	**P**	0-100 g	**71**
	100-250 g	78		100-200 g	78
	250-500 g	88		200-300 g	**82**
				300-400 g	**86**
				400-500 g	**108**
	500-750 g	240		500-750 g	**160**

[33] Tariffs in bold have changed compared with the proposed tariffs in the Draft Decision.

In relation to the Public Tariff for Out UK, Jersey and Isle of Man the DG has made not only changes to reflect the additional two weight steps but also to address GPL's concern that within a number of weight steps the Bulk Mail tariff was in part higher than the Public Tariff. The DG was not able to reduce the Bulk Mail tariff given the low margins and hence the only way to address this concern was to increase the Public Tariff at particular weight steps. The DG has again tried to keep this change as revenue neutral as possible by reducing some other tariffs if the margins allowed him to do so (e.g. for Europe and ROW).

Table 6 Adjustments to Out UK, Jersey and Isle of Man Public Tariff[34]

DRAFT DECISION			FINAL DECISION		
Format	**weight step**	**Price**	**Format**	**weight step**	**Price**
L	0-100 g	43	**L**	0-100 g	**45**
LL	250-500 g	140	**LL**	200-300 g	**125**
	500-750 g	183		300-400 g	**160**
				400-500 g	**195**
				500-750 g	**230**
P	100-250 g	162	**P**	100-200 g	**175**
	250-500 g	211		200-300 g	**193**
				300-400 g	**220**
				400-500 g	**280**
	500-750 g	390		500-750 g	**386**
	>750 (per 250g)	75		>750 (per 250g)	**95**

[34] Tariffs in bold have changed compared with the proposed tariffs in the Draft Decision.

Table 7 Adjustments to Public Tariff for Europe and ROW[35]

		Europe		ROW	
Format	**weight step**	**Draft Decision**	**Final Decision**	**Draft Decision**	**Final Decision**
L	0-10	51	**50**	56	**55**
	11-20	51	**50**	77	**80**
	21-40	65	**63**	106	**105**
	41-60	79	**75**	134	**130**
	61-80	93	**88**	163	**155**
	81-100	107	**100**	191	**180**
LL	0-10	56	**55**	63	**62**
	11-20	56	**55**	84	**82**
	21-40	70	**68**	112	**107**
	41-60	84	**80**	140	**132**
	61-80	98	**93**	168	**157**
	81-100	112	**105**	196	**182**
	101-120	126	**118**	224	**207**
	121-140	140	**130**	252	**232**
	>140 (+20)	14	**12**	28	**25**
P	0-10	86	**88**	90	90
	11-20	86	**88**	111	**110**
	21-40	100	**103**	139	**135**
	41-60	114	**118**	167	**160**
	61-80	128	**133**	195	**185**
	81-100	142	**148**	223	**210**
	101-120	156	**162**	251	**235**
	121-140	170	**176**	279	**260**
	>140 (+20)	14	14	28	**25**

8.5. DG's Final Decision

The DG's Final Decision on all tariffs can be found in Annex A. These tariffs will come into effect from 1st April 2010.

[35] Tariffs in bold have changed compared with the proposed tariffs in the Draft Decision.

9. Licensing of New Postal Operators

The issue of the regulation of new entrants, and how competition in the postal market might be managed, was raised by respondents to the Draft Decision. Currently the regulation of the postal market is undertaken under the Postal (Bailiwick of Guernsey) Law 2001.

By way of background, in 2001 the States approved the commercialisation of Guernsey Post and the introduction of a regulatory framework to ensure postal customers' interests were protected. In approving this package, the States clearly had intended that competition in the postal market would be a positive development. In the September 2001 Billet (Billet D'Etat XVIII, page 1262) stated:

> *"7.11 The key decision for the States in deciding on a Direction to the Regulator is how large or small the monopoly should be and for how long it should last. In order to maximize the benefits to users <u>and introduce competition wherever feasible</u>, the monopoly should be set only at the level that is needed to fund the universal service obligation.*

Since 2001 there has been limited competition in the postal market. This has mainly come from courier companies delivering parcels or documents from outside the Bailiwick or service providers collecting PO Box mail for delivery to businesses. However for what might be referred to as normal post (i.e. non-premium priced), Guernsey Post retains a monopoly on a significant proportion of mail services. It is estimated that about 95% of GPL's current volumes are within the existing £1.35 Reserved Area.

Under the Postal Law the provision of postal services which are non-Reserved Services may be provided without a licence. In effect, only Guernsey Post, as the exclusive provider of postal services in the Reserved Area is legally obliged to hold a licence.

While the DG must apply the law in its current form, he believes consideration should be given to amending the Postal Law to provide for a wider licensing scheme. This will require the States to agree to some minor changes to the Postal Law. The DG has discussed this matter with the C&E Department and it has agreed to bring proposals to make the necessary amendments before the States. .

While the exact details of the licence arrangements will be consulted upon separately, the DG does want to ensure any potential new entrants are aware that a licence may be required in the future. The DG expects to publish for consultation in the New Year outline proposals on this matter. Among the licence conditions the DG expects to consult on are measures to address anti-competitive behaviour and provision for compensation fund for the Reserved Area in the event it becomes a disproportionate burden on GPL in the future.

10. Next Steps

The DG has now concluded his review of this price control and the new tariffs and lower Reserved Area will take effect from 1st April 2010.

The DG has noted the various views on the short nature of this price control and recognises the difficulties that this creates for Guernsey Post's customers. A further price control will be put in place next year and it is anticipated that this will be for a longer duration, most likely a three year control. The DG will commence work on this review in the New Year.

The DG, as he has indicated in the previous section, will commence work on a licensing regime for the postal market, subject to States approval to amend the Postal Law. The DG will work closely with the Commerce & Employment Department to address this issue. The DG invites any postal operator contemplating entering the postal market to meet with him so that he can discuss their interest and the potential nature of any future licensing regime. The DG will consult public on the terms of any licence to be granted to new entrants before finalising this matter.

ENDS/

Annex A Postal Tariffs coming into effect on 1st April 2010

Table A1 Intra Bailiwick Postal Rates - Letter

g.	1st April 2009	1st April 2010
100 max	£0.36	£0.36

Table A2 Intra Bailiwick Postal Rates – Large Letter

g.	1st April 2009	1st April 2010
0 - 100g	£0.36	£0.48
101 – 200g	£0.36 - £0.64	£0.52
201 - 300g	£0.64 - £0.92	£0.56
301 - 400g	£0.92 - £1.20	£0.66
401 – 500g	£1.20 - £1.48	£0.78
501 - 750g max	£1.48 - £2.18	£1.10

Table A3 Intra Bailiwick Postal Rates - Packets

g.	1st April 2009	1st April 2010
0 - 100g	£0.36	£0.71
101 – 200g	£0.36 - £0.64	£0.78
201 - 300g	£0.64 - £0.92	£0.82
301 - 400g	£0.92 - £1.20	£0.86
401 – 500g	£1.20 - £1.48	£1.08
501 – 750g max	£1.48 - £2.18	£1.60
	£0.14 for each 50g	£0.70 for each 250g

Table A4 UK, Jersey & Isle of Man Postal Rates - Letter

g.	1st April 2009	1st April 2010
100 max	£0.43	£0.45

Table A5 UK, Jersey & Isle of Man Postal Rates – Large Letters

g.	1st April 2009	1st April 2010
0 - 100g	£0.43	£0.58
101 – 200g	£0.43 - £1.24	£0.91
201 - 300g	£1.24 - £1.54	£1.25
301 - 400g	£1.54 - £1.84	£1.60
401 – 500g	£1.84 - £2.14	£1.95
501 – 750g max	£2.14 - £2.89	£2.30

Table A6 UK, Jersey & Isle of Man Postal Rates – Packets

g.	1st April 2009	1st April 2010
0 - 100g	£0.43	£0.90
101 – 200g	£0.43 - £1.24	£1.75
201 - 300g	£1.24 - £1.54	£1.93
301 - 400g	£1.54 - £1.84	£2.20
401 – 500g	£1.84 - £2.14	£2.80
501 – 750g max	£2.14 - £2.89	£3.86
	£0.15 for each 50g after	£0.95 for each 250g after

Table A7 International Postal Rates - Letter

	1st April 2009			1st April 2010	
g.	Europe	World zone 1	World zone 2	Europe	R.O.W.
0 - 10g	£0.51	£0.56	£0.56	£0.50	£0.55
11 – 20g	£0.51	£0.77	£0.77	£0.50	£0.80
21 – 40g	£0.69	£1.14	£1.21	£0.63	£1.05
41 – 60g	£0.87	£1.51	£1.65	£0.75	£1.30
61 – 80g	£1.05	£1.88	£2.09	£0.88	£1.55
81 – 100g	£1.23	£2.25	£2.53	£1.00	£1.80

Table A8 International Postal Rates – Large Letters

	1st April 2009			1st April 2010	
g.	Europe	World zone 1	World zone 2	Europe	R.O.W.
0 - 10g	£0.51	£0.56	£0.56	£0.55	£0.62
11 – 20g	£0.51	£0.77	£0.77	£0.55	£0.82
21 – 40g	£0.69	£1.14	£1.21	£0.68	£1.07
41 – 60g	£0.87	£1.51	£1.65	£0.80	£1.32
61 – 80g	£1.05	£1.88	£2.09	£0.93	£1.57
81 – 100g	£1.23	£2.25	£2.53	£1.05	£1.82
101 -120g	£1.41	£2.62	£2.97	£1.18	£2.07
121 -140g	£1.59	£2.99	£3.41	£1.30	£2.32
Each 20g after	£0.18	£0.37	£0.44	£0.12	£0.25

Table A9 International Postal Rates – Packets

	1st April 2009			1st April 2010	
g.	Europe	World zone 1	World zone 2	Europe	R.O.W.
0 - 10g	£0.51	£0.56	£0.56	£0.88	£0.90
11 – 20g	£0.51	£0.77	£0.77	£0.88	£1.10
21 – 40g	£0.69	£1.14	£1.21	£1.03	£1.35
41 – 60g	£0.87	£1.51	£1.65	£1.18	£1.60
61 – 80g	£1.05	£1.88	£2.09	£1.33	£1.85
81 – 100g	£1.23	£2.25	£2.53	£1.48	£2.10
101 -120g	£1.41	£2.62	£2.97	£1.62	£2.35
121 -140g	£1.59	£2.99	£3.41	£1.76	£2.60
Each 20g after	£0.18	£0.37	£0.44	£0.14	£0.25

Table A10a Bulk UK Products: Priority (by air)

	Price per item at 60g (pence)	
"Priority" (by air)	1st April 2009	1st April 2010
120 way sorted Letter	n/a	41.4
Unsorted Large Letter	n/a	65.4
4 way sorted Large Letter	n/a	62.4
120 way sorted Large Letter	n/a	55.4
Unsorted Packet	88.0	142.0
4 way sorted Packet	n/a	137.1
120 way sorted Packet	72.38	117.1

Table A10b Bulk UK Products: Priority (by air)

	Price per g above 60g (pence)	
"Priority" (by air)	1st April 2009	1st April 2010
Unsorted Large Letter	n/a	0.240
4 way sorted Large Letter	n/a	0.240
120 way sorted Large Letter	n/a	0.240
Unsorted Packet	0.300	0.240
4 way sorted Packet	n/a	0.240
120 way sorted Packet	0.273	0.240

Table A11a Bulk UK Products: Economy (by sea)

	Price per item at 60g (pence)	
"Economy" (by sea)	1st April 2009	1st April 2010
Unsorted Large Letter	n/a	59.3
4 way sorted Large Letter	n/a	56.3
120 way sorted Large Letter	n/a	35.6
Unsorted Packet	42.94 (non-MOU)	133.29
4 way sorted Packet	48.58	128.29
120 way sorted Packet	34.77	80.22

Table A11b Bulk UK Products: Economy (by sea)

	Price per g above 60g (pence)	
"Economy" (by sea)	1st April 2009	1st April 2010
Unsorted Large Letter	n/a	0.165
4 way sorted Large Letter	n/a	0.165
120 way sorted Large Letter	n/a	0.14
Unsorted Packet	0.313 (non-MOU)	0.2048
4 way sorted Packet	0.233	0.2048
120 way sorted Packet	0.233	0.1704

Table A12a Bulk Europe and International Products

	Price per item at 60g (pence)	
	1st April 2009	1st April 2010
Europe Letter	n/a	73.37
Europe Large Letter	n/a	79.44
Europe Packet	n/a	105.63
International Letter	n/a	123.13
International Large Letter	n/a	129.20
International Packet	n/a	155.39

Table A12b Bulk Europe and International Products

	Price per item per gram (pence)	
	1st April 2009	1st April 2010
Europe Letter	n/a	0.6111
Europe Large Letter	n/a	0.6111
Europe Packet	n/a	0.6111
International Letter	n/a	1.2222
International Large Letter	n/a	1.2222
International Packet	n/a	1.2222

Table A13a Intra Bailiwick Postal Rates Franked Mail and PPI- Letter

g	1st April 2010
100 max	£0.35

Table A13b Intra Bailiwick Postal Rates Franked mail and PPI- Large Letters

g	1st April 2010
0-100	£0.47
101-200	£0.50
201-300	£0.55
301-400	£0.64
401-500	£0.76
501-750	£1.07

Table A13c Intra Bailiwick Postal Rates Franked Mail and PPI - Packet

g	1st April 2010
0-100	£0.69
101-200	£0.76
201-300	£0.80
301-400	£0.83
401-500	£1.05
501-750	£1.55
751-1000	£2.23
Each 250g after	£0.70

TableA14a UK, Jersey and Isle of Man Postal Rates Franked Mail and PPI-Letter

g	1st April 2010
100 max	£0.44

Table A14b UK, Jersey and Isle of Man Postal Rates Franked Mail and PPI-Large Letter

g	1st April 2010
0-100	£0.56
101-200	£0.88
201-300	£1.21
301-400	£1.55
401-500	£1.89
501-750	£2.23

TableA14c UK, Jersey and Isle of Man Postal Rates Franked Mail and PPI – Packet

g	1st April 2010
0-100	£0.87
101-200	£1.70
201-300	£1.87
301-400	£2.13
401-500	£2.72
501-750	£3.74
751-1000	£4.67
Each 250g after	£0.95

Table A15a International Postal Rates Franked Mail and PPI- Letter

	1 April 2009			1 April 2010	
g	Europe	World zone 1	World zone 2	**Europe**	**ROW**
10	£0.51	£0.56	£0.56	£0.49	£0.53
20	£0.51	£0.77	£0.77	£0.49	£0.78
40	£0.69	£1.14	£1.21	£0.61	£1.02
60	£0.87	£1.51	£1.65	£0.73	£1.26
80	£1.05	£1.88	£2.09	£0.85	£1.50
100 max	£1.23	£2.25	£2.53	£0.97	£1.75

Table A15b International Postal Rates Franked Mail and PPI – Large Letter

	1 April 2009			1 April 2010	
g	Europe	World zone 1	World zone 2	**Europe**	**R.O.W.**
10	£0.51	£0.56	£0.56	£0.53	£0.60
20	£0.51	£0.77	£0.77	£0.53	£0.80
40	£0.69	£1.14	£1.21	£0.65	£1.04
60	£0.87	£1.51	£1.65	£0.78	£1.28
80	£1.05	£1.88	£2.09	£0.90	£1.52
100	£1.23	£2.25	£2.53	£1.02	£1.77
120	£1.41	£2.62	£2.97	£1.14	£2.01
140	£1.59	£2.99	£3.41	£1.26	£2.25
160	£1.77	£3.36	£3.85	£1.38	£2.49
180	£1.95	£3.73	£4.29	£1.49	£2.74
200	£2.13	£4.10	£4.73	£1.61	£2.98
220	£2.31	£4.47	£5.17	£1.73	£3.22
240	£2.49	£4.84	£5.61	£1.84	£3.46
260	£2.67	£5.21	£6.05	£1.96	£3.71
280	£2.85	£5.58	£6.49	£2.08	£3.95
300	£3.03	£5.95	£6.93	£2.19	£4.19
320	£3.21	£6.32	£7.37	£2.31	£4.43
340	£3.39	£6.69	£7.81	£2.43	£4.68
360	£3.57	£7.06	£8.25	£2.54	£4.92
380	£3.75	£7.43	£8.69	£2.66	£5.16
400	£3.93	£7.80	£9.13	£2.77	£5.40
420	£4.11	£8.17	£9.57	£2.89	£5.65
440	£4.29	£8.54	£10.01	£3.01	£5.89
460	£4.47	£8.91	£10.45	£3.12	£6.13
480	£4.65	£9.28	£10.89	£3.24	£6.37
500	£4.83	£9.65	£11.33	£3.36	£6.62
Each 20g thereafter				£0.12	£0.25

Table A15c International Postal Rates Franked Mail and PPI- Packet

g	Europe	World zone 1	World zone 2	**Europe**	**R.O.W.**
10	£0.51	£0.56	£0.56	£0.85	£0.87
20	£0.51	£0.77	£0.77	£0.85	£1.07
40	£0.69	£1.14	£1.21	£1.00	£1.31
60	£0.87	£1.51	£1.65	£1.14	£1.55
80	£1.05	£1.88	£2.09	£1.29	£1.79
100	£1.23	£2.25	£2.53	£1.44	£2.04
120	£1.41	£2.62	£2.97	£1.57	£2.28
140	£1.59	£2.99	£3.41	£1.71	£2.52
160	£1.77	£3.36	£3.85	£1.84	£2.76
180	£1.95	£3.73	£4.29	£1.98	£3.01
200	£2.13	£4.10	£4.73	£2.11	£3.25
220	£2.31	£4.47	£5.17	£2.25	£3.49
240	£2.49	£4.84	£5.61	£2.39	£3.73
260	£2.67	£5.21	£6.05	£2.52	£3.98
280	£2.85	£5.58	£6.49	£2.66	£4.22
300	£3.03	£5.95	£6.93	£2.79	£4.46
320	£3.21	£6.32	£7.37	£2.93	£4.70
340	£3.39	£6.69	£7.81	£3.07	£4.95
360	£3.57	£7.06	£8.25	£3.20	£5.19
380	£3.75	£7.43	£8.69	£3.34	£5.43
400	£3.93	£7.80	£9.13	£3.47	£5.67
420	£4.11	£8.17	£9.57	£3.61	£5.92
440	£4.29	£8.54	£10.01	£3.74	£6.16
460	£4.47	£8.91	£10.45	£3.88	£6.40
480	£4.65	£9.28	£10.89	£4.02	£6.64
500	£4.83	£9.65	£11.33	£4.15	£6.89
Each 20g up to 2000g max	£0.18	£0.37	£0.44	£0.14	£0.25

Table A16 Other Products USO Reserved area

Recorded delivery	No Change
Articles for the blind	No Change
HM Forces Service	No Change
Keepsafe	No Change
Parcel Delivery- redelivery	No Change
Business Reply Service	No Change

Table A17 Other Products USO Non-Reserved area

Redirection of Mail	No Change
Ad-Hoc Collections	No Change
Freepost	No Change
Timed Delivery	No Change
Timed Collection	No Change
Post Restante	No Change
Private Box	No Change
Local Parcels	No Change
UK Parcels	No Change

Table A18 Other Products Non- USO

Mailroom Franking	No Change
Door2Door	No Change
FedEx	No Change

Annex B International evidence about the impact of reducing the reserved area

As noted in chapter 7, the Guernsey postal market has particular features which need to be taken into account in making comparisons with other jurisdictions. Nevertheless, an examination of postal markets in other jurisdictions can provide useful evidence for appropriate approaches to regulating the postal market in Guernsey. The case studies in this Annex draw on a report by ITA Consulting and WIK Consult for the European Commission.[36]

Table B1: Summary of key features of various postal markets

Jurisdiction	Population (millions)	Population density (per km^2)	Estimated market value (letters)	Estimated market value (parcels and express)	EBIT % of corporate revenue
Australia	20.7 (2007)	3 (2008)	€1.6 billion (2008)	€2.2 billion (2004)	12.1% (2008)
Austria	8.3 (2008)	99 (2008)	€1.5 billion (2008)	€740 million (2008)	6.7% (2008)
Cyprus	0.8 (2008)	85 (2008)	€29 million (2007)	€20 million (2007)	n/a
Estonia	1.3 (2008)	30 (2008)	€40 million (2007)	n/a	-2.7% (2007)
Finland	5.3 (2008)	16 (2008)	€1.1 billion (2008)	€860 million (2008)	3.5% (2008)
Germany	82.2 (2008)	230 (2008)	€10.5 billion (2008)	€10.5 billion (2008)	-2.2% (2008)
Japan	128 (2008)	339 (2008)	€11.9 billion (2007)	2.8 trillion JPY (2008)	6.6% (2007)
Malta	0.4 (2008)	1,298 (2008)	€1.8 million (2008)	€4.9 million (2008)	12.4% (2008)
Netherlands	16.4 (2008)	395 (2008)	€2.9 billion (2007)	€1.8 billion (2008)	8.8% (2008)
New Zealand	4.2 (2007)	15 (2007)	€455 million (2008)	n/a	10.6% (2008)
Sweden	9.2 (2008)	20.4 (2008)	€2.9 billion (2008)	€1.7 billion (2008)	6.0% (2008)
UK	61.6 (2008)	252 (2008)	€8.6 billion (2008)	€7 billion (2008)	3.4% (2008/09)
USA	305.8 (2008)	32 (2007)	€41.5 billion (2008)	$US 56.9 billion (2008)	-3.7% (2008)

(Source: Compiled from ITA Consulting and WIK Consult (2009) "The Evolution of the European Postal Market since 1997")

[36] ITA Consulting and WIK Consult (2009) "The Evolution of the European Postal Market since 1997: Country Fiches" accessed at http://ec.europa.eu/internal_market/post/doc/studies/2009-wik-evolution-country-annex_en.pdf

Jurisdictions retaining the reserved area

In some cases, a profitable postal service is guaranteed by a significant reserved area. However, the existence of a significant reserved area limits the emergence of competition and hence the choice available for customers.

Cyprus

The incumbent postal operator in Cyprus is Cyprus Post. Cyprus Post is fully owned by the government and has not yet been corporatised. A reserved area (equal to the maximum European Union conditions) is still maintained in Cyprus and there is no competition in the letter market. National courier services are also important as they provide faster, more reliable services. Overall, the domestic letter post market is considered to be relatively under-developed. Further, while there have been improvements in transit time performance, this is still considered to be an area where there is potential for improvement. The focus of Cyprus Post is on the domestic and cross-border letter markets. Courier services provide the only real competition.

Malta

Maltapost is the universal service provider and the company was fully privatised in 2008. Despite liberalisation of the postal operator, the letter market has retained the maximum reserved area for all letter services. This has meant that competition in the letters market has been limited. In 2007, a licence was issued to Premiere Post Ltd to operate services within the scope of the universal service but Maltapost remains the dominant player.[37]

Outside of the letter segment, competition has emerged in some niche segments such as registered items. The parcel and express market is small and is dominated by international shipments. Given that Malta is a small country, cross-border outgoing plays an important role. In the cross-border market Maltapost plc competes with international companies. Cross-border transit time performance is relatively low. There has also been some limited competition in the delivery of registered items but 85% of customers think that the quality of the postal service would improve if there was more competition in the sector. During the process of privatisation, Maltapost has improved its profitability, particularly through the modernisation of its postal operations.

A study was carried out for the European Commission on the potential impact of full market opening.[38] The study noted Maltapost's view that the postal market was not particularly attractive for new entrants and that any new entrants would only capture a

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[37] Ecorys (2008) "Main developments in the postal sector (2006-2008)", Malta country sheet, accessed at http://circa.europa.eu/Public/irc/markt/markt_consultations/library?l=/postal_services/studies/maltapdf/_EN_1.0_&a=d

[38] PricewaterhouseCoopers (2006) "The Impact on Universal Service of the Full Market Accomplishment of the Postal Internal Market in 2009", accessed at http://ec.europa.eu/internal_market/post/doc/studies/2006-impact-annexes_en.pdf

small share of the market as a result of market opening.[39] The report concluded that full market opening represented both an opportunity and a threat for Maltapost. This was because competition may take some of Maltapost's market share but it was considered possible that Maltapost could mitigate these impacts through increased efficiency.[40]

Malta was given the option to postpone implementation of Directive 2008/6/EC which requires full market opening. Postponement would allow Malta to delay full market opening until 1 January 2013.

Australia

In Australia, the universal service is provided by Australia Post, the incumbent postal operator. Australia Post has a reserved area that covers all letter services weighing up to 250 grams. This large reserved area has meant that Australia Post is the only postal operator providing the delivery of letters. Competition in the delivery of domestic letter post items has not yet emerged. However, customer satisfaction surveys indicate that individual and business customers are highly satisfied with the services provided by Australia Post (approval is above 95% in both cases). The company is also considered to have a modern postal infrastructure which leads to good transit time performance. Australia Post is a highly profitable postal operator with earnings before interest and tax (EBIT) as a per cent of corporate revenue being 12.1% in 2008.

Austria

In Austria, the universal service provider is Österreichische Post AG. The letter market in Austria has been liberalised in line with the EU Postal Directives and a reserved area in line with the second Postal Directive is still in existence. The existence of the reserved area has meant that there is very limited competition. Österreichische Post AG has a dominant market position in the delivery of letters and in the distribution of publications and unaddressed advertising.

The key competitor is Redmail which is active in the delivery of direct mail, unaddressed advertising and distribution of newspapers. The estimated market share of Redmail is less than 2%. The Universal Postal Union has noted that, as a result of upcoming liberalisation, Österreichische Post AG will need to make further efforts to reduce costs.[41] Currently, Österreichische Post AG has established a highly profitable letter post service and has extended its activities to the upstream and downstream segments of the industrial postal value chain but letter post services contribute the major part to total profits.

[39] PricewaterhouseCoopers (2006) "The Impact on Universal Service of the Full Market Accomplishment of the Postal Internal Market in 2009", at p.110, accessed at http://ec.europa.eu/internal_market/post/doc/studies/2006-impact-annexes_en.pdf

[40] PricewaterhouseCoopers (2006) "The Impact on Universal Service of the Full Market Accomplishment of the Postal Internal Market in 2009", at p.110, accessed at http://ec.europa.eu/internal_market/post/doc/studies/2006-impact-annexes_en.pdf

[41] Universal Postal Union (2009) "Status and structures of postal entities in UPU member countries", see Austria, p.2, Financial Management

Jurisdictions with no reserved area but other barriers

Finland

The reserved area was abolished in Finland in 1991, however, postal operators need a licence to provide services within the universal postal service area. The licence includes a universal service obligation and currently one has been granted to Itella Corporation (Posti). Despite full market opening, competition in the letters segment of the market has not emerged. There has been some customer dissatisfaction with the service provided, particularly relating to the price level as well as letters not being delivered on time. Itella Corporation is a profitable company, with these profits largely originating in the traditional mail segment. Itella Corporation has a strong market position (market share is greater than 30%) but some of this market share has been taken over by competitors. Since 2001, the market has seen growth in international volumes and in the turnover of alternative providers. Some competitors have been attracted from other Scandinavian countries, such as Jetpak and Box Group (a subsidiary of Norway Post).

The Aland Islands

The Aland Islands, off the coast of Finland, have a separate postal services provider. Posten på Åland has the right and obligation to provide postal services throughout the region and is responsible for ensuring universal postal services. Posten på Åland is an independent postal administration and is a limited liability company. There is no monopoly or reserved area for this postal provider. Posten på Åland provides postal services on the islands, however, there is competition in the transport sector. The parliament specifies a minimum level for the postal service to be provided on an annual basis. Basic postal services are to be accessible throughout the region and Posten på Åland sets its postal rates, with the prices being based on economic principles. Aland Post is operated on a commercial basis and is required to make a profit.[42]

Japan

The postal market in Japan was fully liberalised in 2002 but due to strict licence conditions competition has not emerged in the correspondence segment. Competition is also limited in the parcel and express market with the top 5 companies accounting for more than 90% of the market. In order to obtain a licence for general correspondence, the licensee needs to fulfil the requirements of the universal service requirements. This includes services such as nationwide delivery 6 days a week. In any case, Japan Post is more of a financial insurance company than a postal service provider with the postal service accounting for less than 10% of total revenues.

USA

There is no reserved areas in the USA. However, competition in letter post is limited as a result of the mailbox monopoly granted to the United States Postal Service

[42] Universal Postal Union (2009) “Status and structures of postal entities in UPU member countries”, accessed at http://www.upu.int/status/en/status_en.pdf

(USPS). USPS is the incumbent postal operator and is part of the executive branch of the US Government. There has been considerable upstream competition which has emerged after the introduction of work-sharing rebates e.g. rebates for pre sorting. In the parcel and express market, the main competitors of USPS are UPS and FedEx. The market is highly concentrated with these players having an aggregated market share greater than 75%. DHL attempted to compete in the US market from 2003 but was not able to be profitable and withdrew in 2008. Due to regulation the profitability of USPS has been limited – a form of rate of return regulation was applied. The commercial flexibility of USPS is very limited and hence its business focus is still on traditional postal services.

Jurisdictions with no reserved area

Estonia

The letter market in Estonia was fully liberalised on 1 April 2009. Even with full market opening Eesti Posti Ltd, the incumbent operator, dominates the market for the delivery of letters. A licence is required for postal operators in the universal service market. There is more competition in the direct mail market which has been open to competition for some time. In particular, there are three competitors with approximately 8% of the market share. The profitability of Eesti Post is limited, mainly due to the challenges of high wages and falling levels of correspondence. The letter market in Estonia is seen to be under-developed. In particular, there is the potential for growth in direct mail and improvements could be made in the quality of service provided.

Germany

The market in Germany has been fully open since 2008 and there is no official designation of the universal service provider. Deutsche Post AG currently provides these services. The universal service has been provided at a high quality level and there has been no negative impact on universal service provision. In addition, business customers have benefited from declining tariffs and an extension of service offerings. Small and medium sized mailers have more choice between different postal operators. Individuals have also benefited as a result of stable postal tariffs, improved accessibility and constantly reliable letters services. Increasing competition on the parcel post segment (consumer parcels) resulted in declining prices and more choice for residential customers. The incumbent postal operator was seen as well prepared for competition in the letter market as a result of improvements in customer orientation and efficiency in service provision. Competition has emerged at a local level, particularly in eastern Germany. The main competitors are TNT Post (2% market share), publishing houses and local mail operators. In 2007, competitors had a market share of 12% (in terms of revenue). Market shares of competing operators increased until 2007. Interestingly, full market opening led to competing postal operators losing market share. Deutsche Post was profitable in the mail segment in 2008 but experienced an overall loss due to the express business and Postbank.

Since the liberalisation process began there has been restructuring of the national letter and parcel market. This has included new sorting technology and delivery sequence sorting. There have also been benefits for consumers. Access to postal services has also improved – there are more access points, extended opening hours and increased choice. Postal tariffs have decreased for all customer groups, with large and medium business mailers benefiting most. The advent of full market opening led Deutsche post to further decrease tariffs. This was largely achieved by reducing the volume thresholds for access products.

Netherlands

The market in the Netherlands was recently opened and the incumbent operator is TNT Post. Prior to this, the printed matter segment was already open and sustainable competition has emerged in direct mail and publications. The main competitors are Sandd and Selektmail (which is owned by Deutsche Post). Both of these competitors offer nationwide delivery services twice a week. In 2008, TNT Post was able to maintain its market share by introducing a low budget direct mail product to be delivered once a week. TNT also modernised its national post operations during the 1990s. TNT Post is still the universal service provider. After full market opening only single piece letters (priced at the standard tariff) were part of the universal postal service, with bulk mail products being excluded. In 2008, 92% of customers were satisfied with TNT post. Transit time performance has been 95% or more since 2000. TNT is also considered to be a highly profitable company. The mail segment has achieved EBIT margins between 15 and 20% and the express business segment achieved margins between 5% and 9%.

New Zealand

The incumbent postal operator is New Zealand Post Ltd which is a state-owned enterprise. New Zealand Post is also the universal service provider. The universal service requirements were fixed in a “Deed of understanding” between the company and the government. The letter market in New Zealand was fully liberalised in 1998 but competition has only emerged in niche markets. Upstream competition has emerged but the incumbent postal operator is still responsible for final delivery. Following full market opening a competitor, Pete’s Post, tried to enter the market but the company is now only providing upstream services. A further registered postal operator is Fastway post and this company has established a competing network of retail outlets. It has an access agreement with New Zealand Post for final delivery of national letter post and international postal items. However, the limited competition has been attributed to New Zealand Post’s relatively low postal tariffs (possible due to being a very efficient postal operator) and the introduction of attractive access products. Customers have benefited from improving quality of service, stable tariffs and an increasing range of postal services. New Zealand Post is considered to be a highly profitable postal operator.

Sweden

The postal market was fully liberalised in 1993 and the nominated universal service provider is Posten AB. Competition has emerged in the business mail segment that accounts for about 70% of total letters. There are more than 30 active postal operators in the Swedish letter post market. The key competitor, Citymail, has achieved a market share of more than 10% in terms of volume and delivers mail twice a week to 54% of Swedish households. Since 2006 the company has been profitable. From 1997 to 2008 the mail volume delivered by Citymail grew by 18% oer year on average. The vast majority of the other operators are small companies that provide local letter post services. In most cases, they use their own stamps and letter boxes and each operator handles volumes between 150 – 2500 letters a day (Post & Telestyrelsen, 2007).The incumbent postal operator and universal service provider Posten AB has remained dominant in the letters business.

After financial problems at the end of the 1990s and a substantial restructuring of the business Posten AB has considerably improved its profitability. In 2008 all business segments were profitable; however, the traditional letters segment still contributes the major part of total profit. In June 2009 the first merger between two national postal operators, Post Danmark and Posten AB, occurred.

United Kingdom

The postal market was fully liberalised in 2006. To date, end to end competition has only emerged in market niches. The key competitor is DX Group mainly offering high quality business-to-business services, particularly document exchange services. There is substantial competition in the upstream segments of postal delivery (collection, transport, and sorting). In 2008/09, access volumes accounted for approximately 30% of total letter post. Of this 30% around two thirds was handled by competitors to Royal Mail and only one third came directly from customers.

The incumbent postal operator and universal service provider is Royal Mail plc which has been a public limited company since 2001. The most important competitors in the access volume market are UK Mail, TNT Post and DHL. In the end-to-end market, competition has emerged in market niches.

The profitability of the national business (Royal Mail plc, Parcelforce and Post Offices Ltd) is relatively low while the European parcel business (GLS) has managed to increase its EBIT margin above 8% since 2004/05. There have been some complaints about Royal Mail services from customers. Customers would like more efficiency, greater reliability and more flexibility in postal services. However, between 2000 and 2007 there have been continual improvements in transit time performance. Business customers have benefited from improved quality of service, more service offerings and lower tariffs resulting from more access products.

Jersey

Jersey does not have a Reserved Area. While so far there has been no new market entry to Jersey, Citipost has recently applied for a licence to enter the Jersey market.

Approach to assessing whether the USO is robust to reductions in the reserved area

To inform the analysis that has been undertaken to assess the impact of reducing the Reserved Area on the provision of the universal service the DG has reviewed approaches taken by other regulators faced with similar issues. In particular, he has looked at how Postcomm approached this issue in the UK, and more generally how Postcomm has modelled the potential impact of its regulatory decisions on the maintenance of the universal service.

1. Postcomm's decision about full market opening

Postcomm's decision document for full market opening included analysis and assessment of whether the universal service would continue to be provided after market opening.[43] Arguably this analysis was less detailed and comprehensive than the analysis carried out by the DG. While Postcomm considered the potential financial impact on Royal Mail's ability to provide the universal service following market opening, but taking account of potential lost volume to competitors, it only used very limited alternative scenarios to a central case. Postcomm also noted that the existence of a price control provided a protection for the universal service if it became evident in future years that there was any risk that revenues were insufficient to cover costs. Overall, the DG believes his analysis is at least as rigorous as that undertaken by Postcomm for its full market opening of the UK market.

2. Postcomm's approach for Royal Mail's 2006 price control review

For its 2006 price control review Postcomm assessed whether the price control was compatible with its primary duty to ensure the provision of the universal service. In addition to ensuring the price control gave Royal Mail sufficient revenues to meet its forward looking efficient costs. This analysis was set out in Postcomm's December 2005 document, "Royal Mail Price and Service Quality Review, Final Proposals for Consultation", and in particular through the detailed analysis in Chapter 10.

Consistent with the approach adopted by the DG, Postcomm made clear in Paragraph 10.10 that its assessment of whether the universal service could be provided was, "...with the expectation that Royal Mail will be managed so as to operate efficiently...". Postcomm noted that its approach could not be wholly the same in assessing the financeability of the price control as other regulators because other regulators often made use of the approach of credit rating agencies to consider whether companies could achieve investment grade credit ratings, but Royal Mail as a Government owned company that does not issue its own debt has not credit rating.

Postcomm tested four main scenarios in addition to the central case of its final proposals (see paras 10.36 and 10.37) which varied a range of parameters including the volumes achieved and the efficiency incentives made. Again, while the DG has adopted scenarios specific to Guernsey, he has nevertheless used a broadly similar scenario based approach. Postcomm also noted that the ability to re-open the price control was a protection against very adverse outcomes in a similar way to the one year price control that the DG has determined.

[43] http://www.psc.gov.uk/postcomm/live/policy-and-consultations/consultations/market-opening-timetable/MarketOpeningDecision-final.pdf

Annex C Respondents to the Draft Decision

Written Responses	
Alderney Chamber of Commerce	Commerce and Employment
Customs and Excise, Immigration and Nationality	Deputy David De Lisle
Michael Fattroini	Flowercard (confidential)
Deputy John Gollop	David Grimshaw
Guernsey Bulk Mailers Association (confidential)	Guernsey Consumer Group
Guernsey Post Limited	Deputy Graham Guille
Healthspan	IEB Trading Limited (confidential)
Deputy David Jones	Deputy Shane Langlois
Deputy Rhoderick Matthews	Deputy Sean McManus
Moonpig (confidential)	MX2 Computers Limited (confidential)
Iain Petch	Policy Council
The Sigma Group (confidential)	Thompson and Morgan (Young Plants) limited (confidential)
Emails	
Cecilia Alflatt	David Bichard
Rob Brox	Mike De Carteret
Beverley Domaille	Julie Fusellier
John Gaisford	Richard Gales
Eric Mahy	Heather Mauger
Anne Sandwith	Peter Tagart
George Trimmer	Doug Hamon
Keith Herring	Iain Timms